As of June 30, 2006, the City's investments (in thousands) by maturity are as follows:

	Years				Fair Value
Pooled Investments with City Treasurer:	Under 1	1-3	3-5	Over 5	(In Thousands)
US Treasury Bills	$ 24,642	$ -	$ -	$ -	$ 24,642
US Treasury Notes	29,497	289,649	14,208	-	333,354
US Agencies - Federal Farm Credit Bank	16,882	24,414	-	-	41,296
US Agencies - Federal Home Loan Bank	78,690	128,783	19,244	-	226,717
US Agencies - Federal Home Loan Mortgage Corporation	204,344	63,882	14,770	-	282,996
US Agencies - Federal National Mortgage Association	185,924	29,531	56,186	-	271,641
Bank Notes	4,950	-	-	-	4,950
Certificate of Deposit	9,832	-	-	-	9,832
Commercial Paper	99,491	-	-	-	99,491
Corporate Notes	60,276	9,764	-	-	70,040
Repurchase Agreement	11,716	-	-	-	11,716
State Local Agency Investment Fund	21,765	-	-	-	21,765
	$ 748,009	$ 546,023	$ 104,408	$ -	$ 1,398,440
Non-Pooled Investments with City Treasurer:					
US Treasury Bills	$ 6,009	$ -	$ -	$ -	$ 6,009
US Treasury Notes	3,108	9,865	-	-	12,973
US Agencies - Federal Farm Credit Bank	1,326	-	-	-	1,326
US Agencies - Federal Home Loan Bank	3,865	8,580	-	-	12,445
US Agencies - Federal Home Loan Mortgage Corporation	44,895	5,906	-	-	50,801
US Agencies - Federal Mortgage Corporation	28,747	-	-	-	28,747
US Agencies - Federal National Mortgage Association	31,803	-	-	-	31,803
Commerical Paper	1,643	-	-	-	1,643
Repurchase Agreements	666	-	-	-	666
	$ 122,062	$ 24,351	$ -	$ -	$ 146,413
Investments with Fiscal Agent, Funds Commission, and Other Investments:					
US Treasury Bills	$ 18,042	$ -	$ -	$ -	$ 18,042
US Treasury Bonds and Notes	23,980	1,080	65	397	25,522
US Agencies - Federal Farm Credit Bank	-	2,530	-	-	2,530
US Agencies - Federal Home Loan Bank	-	22,784	-	-	22,784
US Agencies - Federal Home Loan Mortgage Corporation	7,634	-	-	-	7,634
US Agencies - Federal National Mortgage Association	32,130	-	85	-	32,215
Corporate Bonds and Notes	297	391	546	1,909	3,143
Guaranteed Investment Contracts	20,507	-	-	13,741	34,248
Mortgage Backed Securities - Commercial	-	-	-	113	113
Mortgage Backed Securities - Government	-	-	-	61	61
Common Stock	3,261	-	-	-	3,261
Mutual Funds - Equity	324,071	-	-	-	324,071
Mutual Funds - Fixed Income	327,192	-	-	-	327,192
Money Market Mutual Funds	62,505	-	-	-	62,505
Cash	10	-	-	-	10
	$ 819,629	$ 26,785	$ 696	$ 16,221	$ 863,331
Total Investments	$ 1,689,700	$ 597,159	$ 105,104	$ 16,221	$ 2,408,184
Total Deposits					16,880
Total Cash on Hand					206
Total Investments, Deposits, and Cash on Hand (Includes SDCERS Pooled Cash & Investments with the City - $3,960)					$ 2,425,270

g. Interest Rate Risk – San Diego City Employees' Retirement System

SDCERS' domestic convertible bond portfolio is not subject to interest rate risk because convertible bonds are usually positively correlated to interest rate movements compared to other fixed income securities. SDCERS' fixed income portfolios use duration to measure how changes in interest rates will affect the value of the portfolios. The following tables display duration analysis for SDCERS' two-core plus domestic fixed income portfolios and single international fixed income portfolio, based on holdings as of June 30, 2006.

Domestic Fixed Income Portfolio
(with tactical discretion to invest in non-U.S. fixed income securities)
Portfolio Duration Analysis as of June 30, 2006

Type of Security	Fair Value (in thousands)	Percentage of Fair Value	Effective Duration (in years)	Effective Duration Contribution to Portfolio (in years)	Percent Duration of Portfolio
Credit Obligations:					
Corporate Bonds	$ 3,551	0.9%	5.60	0.05	0.9%
High Yield	8,122	2.0%	1.86	0.04	0.7%
Municipal Bonds	4,255	1.0%	15.21	0.16	3.1%
U.S. Government & Agency Obligations:					
U.S. Treasuries	31,276	7.7%	6.32	0.49	9.4%
U.S. Agencies	9,451	2.3%	4.18	0.10	1.9%
International Government:					
Sovereign & Yankee Bonds	3,436	0.8%	(23.67)	(0.20)	-3.9%
Emerging Markets	2,704	0.7%	3.35	0.02	0.4%
Collateralized Mortgage Obligations:					
Mortgages	202,839	50.0%	4.96	2.48	48.0%
Collateralized Mortgage Obligations	19,596	4.8%	2.90	0.14	2.7%
Short-Term/Other:					
Miscellaneous	4,163	1.0%	1.88	0.02	0.4%
Cash/Cash Equivalents	116,315	28.8%	6.55	1.87	36.4%
Total Portfolio	$ 405,708	100.0%		5.17	100.0%

The above portfolio is restricted to a duration of +/- 2 years from that of the effective duration of the Lehman Brothers Aggregate Index.

Due to the very small market value percentage, the sector duration for Sovereign and Yankee bonds appears inflated. The negative duration contribution from the Non-U.S. sector was an expression of the manager's view that the intermediate interest rates in Europe and Japan would rise. This exposure was put in place in the International Sector Fund via pay fixed interest rate swaps, bringing the sector fund duration to -2.52 years (while having a positive market value) and the duration contribution from that commingled vehicle to -0.08 years. The remaing -0.12 years of duration contribution came from direct investments in pay fixed interest rate sweeps.

Source: SDCERS' CAFR as of June 30, 2006

Domestic Fixed Income Portfolio
Portfolio Duration Anaylsis
As of June 30, 2006

Type of Security	Fair Value (In Thousands)	Effective Duration	Benchmark Duration	Difference
Governments	$ 158,383	5.74	4.50	1.24
Corporates	98,204	4.56	5.82	(1.26)
Mortgage Backed Securities	159,473	3.57	4.57	(1.00)
Asset-Backed Securities	12,959	3.98	2.76	1.22
Cash Equivalents (1)	(13,556)	(0.01)	0.00	(0.01)
Totals	$ 415,463	4.76	4.80	(0.04)

The above strategy is restricted to an average duration of +/- 1 year from that of the effective duration of the the Lehman Brothers Aggregate Index.
(1) Net cash expense is included on this schedule, as cash is a portfolio duration arrangement tool in fixed income investing.
**Source: SDCERS' CAFR as of June 30, 2006*

International Fixed Income Portfolio
Portfolio Duration Anaylsis
As of June 30, 2006

Type of Security	Fair Value (In Thousands)	Effective Duration	Benchmark Duration	Difference
Cash and Forward Foreign Exchange	$ 5,874	0.00	0.00	0.00
Asset Backed Securities	3,322	4.48	0.00	4.48
Credit Obligations	26,236	3.70	0.00	3.70
International Government and Agency	140,350	6.57	6.12	0.45
Totals	$ 175,782	5.88	6.12	(0.24)

The above strategy is restricted to an average duration of between .5 and 1.5 times that of the J.P. Morgan Non-U.S. Bond Index.
**Source: SDCERS' CAFR as of June 30, 2006*

Investments Highly Sensitive to Interest Rate Changes (SDCERS)

SDCERS' fixed income investment managers construct portfolios that contain fixed income and derivative securities that all have attributes of convexity and are all sensitive in varying degrees to changes in interest rates. SDCERS' managers select securities that when aggregated together create an overall investment strategy and total portfolio duration.

SDCERS' domestic fixed income portfolio (with tactical discretion to invest in non-U.S. securities) uses two methods to measure interest rate sensitivity. The first measure is "Bull" Duration, the scenario whereby interest rates decline by 50 basis points. The second measure is "Bear" Duration, the scenario whereby interest rates rise by 50 basis points. The analysis of interest rate change on duration for this portfolio as of June 30, 2006 is shown below.

Domestic Fixed Income Portfolio
(with tactical discretion to invest in non-U.S. securities)

Total Effective Duration:	5.17 years
Bull Duration:	4.50 years – portfolio duration shortens by -0.67 years during a 50 basis point rally (contraction risk)
Bear Duration:	5.64 years - portfolio duration lengthens by +.0.47 years during a 50 basis point sell off (extension risk)

Interest rate sensitivity for SDCERS' domestic fixed income portfolio is based on aggregate holdings. The composite characteristics of the portfolio represent an average sensitivity within one year of the Lehman Brothers Aggregate Index benchmark. As of June 30, 2006, the total values of securities that are more highly sensitive to interest rate changes in this portfolio are shown below.

Domestic Fixed Income Portfolio

Holdings (U.S. Treasury and Corporate securities) with greater than 10 years duration totaled $34,451, or 8.27% of the portfolio.
Holdings with interest only strips and inverse floating rate notes totaled $9,845, or 2.37% of the portfolio.

The analysis of high interest rate sensitivity for the international fixed income portfolio is displayed below.

International Fixed Income Portfolio

Total effective duration: 5.88 years
Duration with 50 basis point decrease in interest rates: -2.7138% decrease in portfolio value.

Summary of Cash and Investments (In Thousands)
San Diego City Employees' Retirement System

Domestic Fixed Income Portfolio (with tactical discretion)	$	405,708
Domestic Fixed Income Portfolio		429,019
International Fixed Income Portfolio		175,782
Securities Lending Collateral		581,290
Cash and Investments exempt from GASB 40 disclosure		3,305,590
Total Cash and Investments for SDCERS (excluding Pooled Investments with the City)	$	4,897,389

h. Credit Risk – City of San Diego *(excluding San Diego City Employees' Retirement System)*

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. At June 30, 2006, the City's investments and corresponding credit ratings are as follows:

Pooled Investments with City Treasurer:	Moody's	S&P	Fair Value	Percentage
US Treasury Notes	Exempt	Exempt	$ 24,642	1.76%
US Treasury Bills	Exempt	Exempt	333,354	23.85%
US Agencies - Federal Farm Credit Bank	Aaa	N/A	41,296	2.95%
US Agencies - Federal Home Loan Bank (1)	Aaa	N/A	190,670	13.64%
US Agencies - Federal Home Loan Bank (1)	Not Rated	A-1+	36,047	2.58%
US Agencies - Federal Home Loan Mortgage Corporation (1)	Aaa	N/A	158,840	11.36%
US Agencies - Federal Home Loan Mortgage Corporation (1)	Not Rated	A-1+	124,156	8.88%
US Agencies - Federal National Mortgage Association (1)	Aaa	N/A	133,162	9.52%
US Agencies - Federal National Mortgage Association (1)	Not Rated	A-1+	138,479	9.90%
Bank Notes	Aa2	N/A	4,950	0.35%
Certificate of Deposit	Aa2	N/A	9,832	0.70%
Commercial paper	P-1	N/A	99,491	7.11%
Corporate Notes	Aaa	N/A	19,625	1.40%
Corporate Notes	Aa1	N/A	9,903	0.71%
Corporate Notes	Aa2	N/A	5,478	0.39%
Corporate Notes	Aa3	N/A	25,045	1.79%
Corporate Notes	A3	N/A	9,989	0.71%
Repurchase Agreement	Not Rated	Not Rated	11,716	0.84%
State Local Agency Investment Fund	Not Rated	Not Rated	21,765	1.56%
Subtotal - Pooled Investments			$ 1,398,440	100.00%

Non-Pooled Investments with City Treasurer:	Moody's	S&P	Fair Value	Percentage
US Treasury Bills	Exempt	Exempt	$ 6,009	4.10%
US Treasury Notes	Exempt	Exempt	12,973	8.86%
US Agencies - Federal Farm Credit Bank	P-1	N/A	1,326	0.91%
US Agencies - Federal Home Loan Bank (1)	Aaa	N/A	8,580	5.86%
US Agencies - Federal Home Loan Bank (1)	Not Rated	A-1+	3,865	2.64%
US Agencies - Federal Home Loan Mortgage Corporation (1)	Aaa	N/A	5,906	4.03%
US Agencies - Federal Home Loan Mortgage Corporation (1)	Not Rated	A-1+	44,895	30.67%
US Agencies - Federal Mortgage Corporation (1)	P-1	N/A	4,006	2.74%
US Agencies - Federal Mortgage Corporation (1)	Not Rated	A-1+	24,741	16.90%
US Agencies - Federal National Mortgage Association (1)	Not Rated	A-1+	31,803	21.72%
Commerical Paper	P1	N/A	1,643	1.12%
Repurchase Agreement	Not Rated	Not Rated	666	0.45%
Subtotal - Non-Pooled Investments			$ 146,413	100.00%

"Exempt" - Per GASB 40, US Treasury Obligations do not require disclosure of credit quality.

"N/A" - S&P rating not applicable, Moody's rating provided

(1) More than 5% of total investments are with U.S. Agencies whose debt is not guaranteed by the U.S. Government.

(ratings continued on next page)

Investments with Fiscal Agent, Funds Commission, and Other Investments:	Moody's	S&P	Fair Value	Percentage
US Treasury Bills	Exempt	Exempt	$ 18,042	2.09%
US Treasury Notes and Bonds	Exempt	Exempt	25,522	2.96%
US Agencies - Federal Farm Credit Bank	Aaa	N/A	2,530	0.29%
US Agencies - Federal Home Loan Bank	Aaa	N/A	22,784	2.64%
US Agencies - Federal Home Loan Mortgage Corporation	Not Rated	A-1+	7,634	0.88%
US Agencies - Federal National Mortgage Association	Aaa	N/A	85	0.01%
US Agencies - Federal National Mortgage Association	Not Rated	A-1+	32,130	3.72%
Corporate Bonds and Notes	Aaa	N/A	198	0.02%
Corporate Bonds and Notes	Aa1	N/A	63	0.01%
Corporate Bonds and Notes	Aa2	N/A	396	0.05%
Corporate Bonds and Notes	Aa3	N/A	687	0.08%
Corporate Bonds and Notes	A1	N/A	896	0.10%
Corporate Bonds and Notes	A2	N/A	582	0.07%
Corporate Bonds and Notes	A3	N/A	273	0.03%
Corporate Bonds and Notes	Baa1	N/A	49	0.01%
Guaranteed Investment Contracts	Not Rated	Not Rated	34,247	3.97%
Mortgage Backed Securities - Commercial	Aaa	N/A	113	0.01%
Mortgage Backed Securities - Government	Not Rated	Not Rated	61	0.01%
Common Stock	Not Rated	Not Rated	3,261	0.38%
Mutual Funds - Equity	Not Rated	Not Rated	324,071	37.54%
Mutual Funds - Fixed Income	Not Rated	Not Rated	327,192	37.89%
Money Market Mutual Funds	Aaa	Not Rated	62,505	7.24%
Cash	Not Rated	Not Rated	10	0.00%
Subtotal - Other Investments			$ 863,331	100.00%
Total Investments			$ 2,408,184	
Total Deposits			16,880	
Total Cash on Hand			206	
Total Investments, Deposits, and Cash on Hand*			$ 2,425,270	

*(includes SDCERS Pooled Cash & Investments with the City - $3,960)

"Exempt" - Per GASB 40, US Treasury Obligations do not require disclosure of credit quality.

"N/A" - S&P rating not applicable, Moody's rating provided

(1) More than 5% of total investments are with U.S. Agencies whose debt is not guaranteed by the U.S. Government.

Concentration of Credit Risk – City of San Diego

Concentration of credit risk is the risk of loss attributed to the relative size of an investment in a single issuer. As of June 30, 2006, the City exceeded the 5% limit of total investments for issuers of various U.S. Agencies. Investments exceeding the 5% limit are referenced in the credit ratings table above. Investments issued explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are exempt.

i. Credit Risk – San Diego City Employees' Retirement System

SDCERS' fixed income portfolios are sensitive to credit risk. Unless information is available to the contrary, obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government are not considered to have credit risk and do not require disclosure of credit quality. "NR" represents those securities that are not rated and "NA" represents those securities that are not applicable to the rating disclosure requirements. The following tables identify the credit quality for SDCERS' two domestic fixed income portfolios, based on holdings as of June 30, 2006.

Domestic Fixed Income Portfolio
(with tactical discretion to invest in non-U.S. fixed income securities)
Credit Risk Analysis as of June 30, 2006

S&P Quality Rating	Moody's Quality Rating	Total Fair Value (in thousands)	Credit Obligations	U.S. Government & Agency Obligations	International Government Obligations	Collateralized Mortgage Obligations	Short-Term/ Other
AAA	Aaa	$ 245,808	$ -	$ 30,606	$ 1,308	$ 213,894	$ -
AAA	NA	8,541	-	-	-	8,541	-
A1	P1	20,609	-	-	-	-	20,609
A1+	P1	74,848	-	-	-	-	74,848
AA+	Aa2	361	361	-	-	-	-
AA	Aa1	12,218	586	1,149	(1,019) *	-	11,502
AA	Aa2	(1,216)	187	-	(1,403) *	-	-
AA-	Aa1	8,425	-	-	-	-	8,425
AA-	Aa3	(13,392)	-	(1)	(13,391) *	-	-
A+	A1	3,105	-	-	-	-	3,105
A+	Aa3	-	-	-	-	-	-
A	A1	6,391	563	(3)	4,743	-	1,088
A	A2	-	-	-	-	-	-
A-	A2	987	-	-	186	-	801
A-	Baa2	202	202	-	-	-	-
BBB+	A2	1,825	1,725	-	-	-	100
BBB	Baa1	2,064	186	-	1,878	-	-
BBB	A3	492	492	-	-	-	-
BBB	Baa3	2,686	2,686	-	-	-	-
BB	Ba3	1,335	695	-	640	-	-
BB	Ba1	2,598	2,598	-	-	-	-
B	B2	2,123	2,123	-	-	-	-
B	B3	11	11	-	-	-	-
B+	Caa2	2,695	2,695	-	-	-	-
NR	NR	22,176	-	8,978 **	13,198	-	-
NR	AAA	818	818	-	-	-	-
NR	Aa2	(3)	-	(3) *	-	-	-
TOTALS		$ 405,707	$ 15,928	$ 40,726	$ 6,140	$ 222,435	$ 120,478

* Negative amounts are representative of pay fixed interest rate swaps.

** This value represents swaptions that are not rated.

Concentration guidelines for this portfolio are as follows:

Maximum Exposure (except U.S. Treasury/Agency Organization for Economic Co-operation and Development Government Issues)

Issue	3% of portfolio
Issuer	5% of portfolio
Foreign Investments	30% of portfolio
Emerging Market Exposure	10% of portfolio
Foreign Currency Exposure	25% of non-U.S. dollar investments

Source: SDCERS' CAFR as of June 30, 2006

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Domestic Fixed Income Portfolio
Credit Risk Analysis as of June 30, 2006

S&P Quality Rating	Total Fair Value (in thousands)	Governments	Corporates	Mortgaged-Backed Securities	Asset-Backed Securities
US Treasury	$ 158,812	$ 158,383	$ -	$ 429	$ -
AAA	112,111	-	3,005	99,803	9,303
AA+	3,364	-	-	-	3,364
A+	11,759	-	11,759	-	-
A-	15,438	-	15,438	-	-
A	4,567	-	4,567	-	-
BBB+	6,856	-	6,856	-	-
BBB	3,801	-	3,801	-	-
BBB-	20,401	-	20,401	-	-
BB+	4,195	-	4,195	-	-
BB	15,700	-	15,700	-	-
BB-	3,692	-	3,400	-	292
B+	8,743	-	8,743	-	-
B-	339	-	339	-	-
NA	3,882	-	-	3,882	-
NR (1)	55,359	-	-	55,359	-
TOTALS	$ 429,019	$ 158,383	$ 98,204	$ 159,473	$ 12,959

Moody's Quality Rating	Total Fair Value (in thousands)	Governments	Corporates	Mortgaged-Backed Securities	Asset-Backed Securities
US Treasury	$ 158,812	$ 158,383	$ -	$ 429	$ -
Aaa	56,797	-	3,005	44,489	9,303
Aa3	8,187	-	8,187	-	-
A1	8,139	-	8,139	-	-
A2	6,710	-	6,710	-	-
Baa1	4,914	-	4,914	-	-
Baa2	13,981	-	13,981	-	-
Baa3	16,992	-	16,992	-	-
Ba1	14,818	-	14,818	-	-
Ba2	14,894	-	14,602	-	292
Ba3	3,585	-	3,585	-	-
B3	3,271	-	3,271	-	-
NA	62,560	-	-	59,196	3,364
NR (1)	55,359	-	-	55,359	-
TOTALS	$ 429,019	$ 158,383	$ 98,204	$ 159,473	$ 12,959

(1) Issued by governmental agencies.

Concentration guidelines for this portfolio are as follows:

Maximum Exposure (except U.S. Treasury/Agency Organization for Economic Co-operation and Development Government Issues)

Issue	3% of portfolio
Issuer	5% of portfolio
Foreign Investments	30% of portfolio
Emerging Market Exposure	10% of portfolio
Foreign Currency Exposure	25% of non-U.S. dollar investments

Source: SDCERS' CAFR as of June 30, 2006

SDCERS' international fixed income portfolio is limited to a minimum average portfolio quality of A (market value weighted) and a minimum credit quality at the time of purchase of Ba/BB or equivalent by at least one of the major rating services. The following table identifies the credit quality for SDCERS' international fixed income portfolio, based on holdings as of June 30, 2006. Credit ratings refer to the long-term foreign currency rating.

International Fixed Income Portfolio
Credit Risk as of June 30, 2006

S&P Quality Rating	Total Fair Value (in thousands)	Cash & Forward Foreign Exchange	Asset Backed Securities	Credit Obligations	International Government & Agency Obligations
AAA	$ 145,803	$ 5,874	$ 3,322	$ 25,891	$ 110,716
AA+	7,808	-	-	-	7,808
AA-	14,321	-	-	-	14,321
A-	3,428	-	-	345	3,083
BBB	1,805	-	-	-	1,805
BB-	1,275	-	-	-	1,275
B+	537	-	-	-	537
B	396	-	-	-	396
B-	409	-	-	-	409
TOTALS	$ 175,782	$ 5,874	$ 3,322	$ 26,236	$ 140,350

Source: SDCERS' CAFR as of June 30, 2006

Subprime Market Activity

The recent events surrounding subprime residential mortgage-backed securities and the housing real estate market have not to date materially affected investment performance of SDCERS. Future investment returns could be adversely impacted due to market liquidity issues or "credit crunch" experienced as a result of the fall out in the collateralized debt obligation markets or forecasts of an economic slow down or recession.

SDCERS invests in a diversified portfolio with allocations to equities, fixed income and real estate, both domestic and international to reduce risk. SDCERS' portfolio has a neutral market weight to equity securities classified as financial companies. SDCERS is minimally exposed to asset-backed securities that are collateralized by subprime mortgages. SDCERS' domestic fixed income managers invest in Agency pass through mortgage securities that are guaranteed by the U.S. Government. Additionally, in any collateralized mortgage obligations or asset-backed securities, SDCERS' managers invest in the most highly-rated, self-liquidating (near to maturity), senior positions.

Management of SDCERS has recently contacted all of SDCERS' publicly-traded investment managers to understand the risks to their portfolios resulting from recent market activity. Management is comfortable that SDCERS' investment managers have positioned their respective portfolios to protect against various market factors. Management will continue to monitor manager investment performance in accordance with SDCERS' Investment Policy Statement.

j. Concentration of Credit Risk - San Diego City Employees' Retirement System

Concentration of credit risk is the risk of loss attributed to the relative size of an investment in a single issuer. As of June 30, 2006, no single issuer exceeded 5% of SDCERS' total investments. Investments issued explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded.

k. Custodial Credit Risk

Deposits – City of San Diego (*excluding San Diego City Employees' Retirement System*)

At June 30, 2006, the carrying amount of the City's cash deposits was approximately $2,607, and the bank balance was approximately $16,480, the difference of which is substantially due to deposits in transit and outstanding checks. For the balance of cash deposits in financial institutions, approximately $492 was covered by federal depository insurance and approximately $15,988 was uninsured. Pursuant to the California Government Code, California banks and savings and loan associations are required to secure the City's deposits not covered by Federal Depository Insurance by pledging government securities as collateral. As such, $15,282 of the City's deposits are pledged at 110% and held by a bank acting as the City's agent, in the City's name. The remaining $706 is uninsured and uncollateralized and includes the following: approximately $655 in deposits relating to San Diego Data Processing Corporation and $51 in deposits relating to Southeastern Economic Development Corporation, Inc.

The City also has deposits held in escrow accounts with a carrying amount and bank balance of approximately $14,273. For the balance of deposits in escrow accounts, approximately $1,327 was covered by federal depository insurance and securities insurance protection. The remaining balance of $12,946 was uninsured. Pursuant to the California Government Code, California banks and savings and loans associations are required to secure the City's deposits in excess of insurance by pledging government securities as collateral. As such, $12,946 of the City's deposits in escrow accounts are collateralized and pledged at 110%.

Deposits – San Diego City Employees' Retirement System

SDCERS' is exposed to custodial credit risk for uncollateralized cash and cash equivalents that are not covered by federal depository insurance. At June 30, 2006, the amount of cash and cash equivalents on deposit with SDCERS' custodial bank totaled $ 92,114.

Investments – City of San Diego (*excluding San Diego City Employees' Retirement System*)

The City's investments at June 30, 2006 are categorized as described below, including required disclosures for securities lending:

Category 1:	Insured or registered, with securities held by the City or its agent in the City's name.
Category 2:	Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the City's name.
Category 3:	Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the City's name.

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Non–Categorized: Includes investments made directly with another party, real estate, direct investments in mortgages and other loans, open-end mutual funds, pools managed by other governments, annuity contracts and guaranteed investment contracts.

At June 30, 2006, the City's investments at fair value included Category 3 type investments, all of which are within the Cemetery Perpetuity Fund's portfolio with Northern Trust Bank. The following is a summary of the City's investments (in thousands) exposed to custodial credit risk:

Investment Type		Fair Value
US Treasury Bonds and Notes	$	1,656
US Agencies		85
Corporate Bonds and Notes		3,144
Mortgage Backed Securities - Commercial		113
Mortgage Backed Securities - Government		61
Common Stock		3,261
Total:	$	8,320

Investments – San Diego City Employees' Retirement System

SDCERS' is not exposed to any custodial credit risk related to any investments. As of June 30, 2006, 100% of SDCERS' investments were held in SDCERS' name.

Securities Lending Collateral – San Diego City Employees' Retirement System

SDCERS' is exposed to custodial credit risk for the securities lending collateral such that certain collateral is received in the form of letters of credit, tri-party collateral or securities collateral. The fair value of securities on loan collateralized by these non-cash vehicles totaled $8,700 as of June 30, 2006 and are at risk as the collateral for these loaned securities is not held in SDCERS' name and cannot be sold without a borrower default. The cash collateral held by SDCERS' custodian in conjunction with the securities lending program, which totaled $581,290 as of June 30, 2006, is also at risk as it is invested in a pooled vehicle managed by the custodian.

I. Restricted Cash and Investments – City of San Diego

Cash and investments at June 30, 2006 that are restricted by legal or contractual requirements are comprised of the following:

Nonmajor Governmental Funds		
Reserved for Debt Service	$	121,772
Permanent Endowments		14,588
Total Nonmajor Governmental Funds		136,360
Environmental Services Enterprise Fund		
Funds set aside for landfill site closure and maintenance costs		31,814
Total Environmental Services Enterprise Fund		31,814
Water Utility Enterprise Fund		
Customer deposits		3,849
Interest and redemption funds		49,391
Total Water Utility Enterprise Fund		53,240
Sewer Utility Enterprise Fund		
Interest and redemption funds		21,079
Total Sewer Utility Enterprise Fund		21,079
Internal Service Fund		
San Diego Data Processing Corporation		133
Total Internal Service Fund		133
Miscellaneous Agency Funds		
Retention held in escrow		14,273
Total Miscellaneous Agency Funds		14,273
Total Restricted Cash & Investments	$	256,899

Summary of Total Cash and Investments:

Total Unrestricted Cash and Investments	$	7,065,760
Total Restricted Cash and Investments		256,899
Total Cash and Investments		7,322,659

Total Governmental Activities	$	1,183,803
Total Business-Type Activities		532,267
Total Fiduciary Activities		5,606,589
Total Cash and Investments	$	7,322,659

m. Foreign Currency Risk – San Diego City Employees' Retirement System

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The following table represents SDCERS' securities (in thousands) held in a foreign currency as of June 30, 2006.

Local Currency Name	Cash	Equity	Fixed income	Other	Total
Australian Dollar	$ 5,103	$ 4,510	$ -	$ -	$ 9,613
Brazilian Real	31	2,924	-	-	2,955
Canadian Dollar	122	24,210	10,249	-	34,581
Danish Krone	-	1,205	8,295	-	9,500
Euro Currency	5,914	228,531	66,872	-	301,317
Hong Kong Dollar	43	7,605	-	-	7,648
Hungarian Forint	-	1,099	-	-	1,099
Indonesian Rupiah	16	1,763	-	-	1,779
Israeli Shekel	-	402	-	-	402
Japanese Yen	1,700	133,700	43,483	-	178,883
Mexican Peso	-	2,375	-	-	2,375
New Zealand Dollar	-	925	-	-	925
Norwegian Krone	-	6,630	11,490	-	18,120
Philippine Peso	-	516	-	-	516
Pound Sterling	101	84,082	19,399	(79)	103,503
Singapore Dollar	-	16,083	-	-	16,083
South African Rand	404	4,896	-	-	5,300
South Korean Won	-	12,550	2,804	-	15,354
Swedish Krona	-	9,160	-	-	9,160
Swiss Franc	-	42,711	-	-	42,711
Thailand Baht	-	2,403	-	-	2,403
TOTALS	$ 13,434	$ 588,280	$ 162,592	$ (79)	$ 764,227

The foreign exchange exposure in SDCERS' international equity small cap value portfolio (an institutional mutual fund investment) is not included in this disclosure.

The negative value on Other represents Put Options written denominated in Pound Sterling.

n. Derivative Instruments - San Diego City Employees' Retirement System

SDCERS' investment managers, as permitted by specific investment guidelines in their investment advisory agreement, may invest in or otherwise enter into transactions involving derivative financial instruments, consistent with the objectives established by the Board's investment policies. These instruments include futures, options and swaps. By Board policy these investment vehicles may not be used to leverage SDCERS' portfolio. These instruments are used primarily to enhance a portfolio's performance and to reduce its risk or volatility. SDCERS could be exposed to credit risk in the event of non-performance by counterparties; however, SDCERS enters into derivative transactions with high-quality institutions, and no losses due to counterparty non-performance on derivative financial instruments have been incurred. Credit and legal risks are also mitigated through the use of exchange traded contracts on organized exchanges. SDCERS is exposed to market risk, which is the risk that future changes in market conditions may make an instrument less valuable. Exposure to market risk is managed in accordance with investment policy guidelines, through buying or selling instruments or entering into offsetting positions.

The notional (underlying) or contractual amounts of derivatives indicate the extent of SDCERS' involvement in the various types and uses of derivative financial instruments and do not measure the exposure to credit or market risks and do not necessarily represent amounts exchanged by the parties. The amounts exchanged are determined by reference to the notional amounts and the other terms of the derivatives.

The aggregate notional or contractual amounts for SDCERS' derivative financial instruments at June 30, 2006 were as follows:

Money Market Futures	$	542,696
Government Bond Futures		27,843
Options		(1,533)
Swaps		23
Total Derivatives	$	569,029

**Source: SDCERS' CAFR as of June 30, 2006*

Futures contracts are contracts in which the buyer agrees to purchase and the seller agrees to make delivery on a specific financial instrument on a predetermined date and price. Gains and losses on futures contracts are settled daily based on a notional (underlying) principal value and do not involve an actual transfer of the specific instrument. Futures contracts are standardized and are traded on exchanges. The exchange assumes the risk that a counterparty will not pay and generally requires margin payments to minimize such risk.

Option contracts provide the option purchaser with the right, but not the obligation, to buy or sell the underlying security at a set price during a period or at a specified date. The option writer is obligated to buy or sell the underlying security if the option purchaser chooses to exercise the option. SDCERS uses exchange traded and over-the-counter options. Options were sold and proceeds were received to enhance fixed income portfolio performance. Option contracts sold were predominantly on money market and short term instruments of less than one-year to maturity. On call option contracts, if interest rates remained steady or declined during the option contract periods, the contracts would expire unexercised. By contrast, on put option contracts, if interest rates rose sufficiently to result in the purchase of the securities on or before the end of the option periods, this would occur at prices attractive to the portfolio manager.

Swap agreements are used to modify investment returns or interest rates on investments. Swap transactions involve the exchange of investment returns or interest rate payments without the exchange of the underlying principal amounts. These swaps could expose investors entering into these types of arrangements to credit risk in the event of non-performance by counterparties.

o. Discretely Presented Component Units

San Diego Convention Center Corporation

Deposits

On June 30, 2006, the carrying amount of the San Diego Convention Center Corporation's (SDCCC) cash on hand and deposits was $978 and the bank balance was $947. Of the bank balance, $400 was covered by federal depository insurance. The remaining balance was either collateralized with the collateral held by an affiliate of the counterparty's financial institution or is uncollateralized, and therefore exposed to custodial credit risk.

Investments

At June 30, 2006, SDCCC had $12,940 in several money market mutual fund investments. In addition, an investment balance of $1,458 was maintained in two certificates of deposit with terms of approximately one year each. Neither the money market mutual funds nor the certificates of deposit are rated by credit rating agencies. SDCCC does not have a formal deposit and investment policy that addresses credit quality risk.

San Diego Housing Commission

Deposits

The carrying amount of the Housing Commission's deposits, which included cash and non-negotiable certificates of deposit, was $67,566 and the bank balance was $68,589 at June 30, 2006. The bank balances were fully insured and/or collateralized with securities held by the pledging financial institutions in the Commission's name. The California Government Code requires California banks and savings and loan associations to secure Commission's deposits by pledging securities as collateral. This Code states that collateral pledged in this manner shall have the effect of perfecting a security interest in such collateral superior to those of a general creditor. Thus, collateral for cash deposits is considered to be held in the Commission's name.

Investments

Policy

In accordance with state statutes and HUD regulations, Commission has authorized the Controller/Budget Officer to invest in obligations of the U.S. Treasury and U.S. Government agencies. The Commission is empowered by HUD Notice PIH 96-33 to invest HUD funds in the following:

Investment Type
US Treasury Obligations (bills, bonds, or notes)
US Agencies
Local Agency Investment Fund
Demand and Savings Deposits (1)
Money Market Deposit Accounts (1)
Super NOW Accounts (1)
Negotiable Certificates of Deposit (1)
Repurchase/Reverse Repurchase Agreements (2)
Sweep Accounts (1)
Money Market Mutual Funds
Trust Indentures/Contracts
Principal Only Strips

Footnotes:

(1) Deposits in excess of the insured amounts must be 100% collateralized.

(2) Securities purchased under these agreements shall be no less than 102% of the market value.

Source: San Diego Housing Commission Investment Policy

The San Diego Housing Commission is empowered by California Government Code (CGC) Sections 5922 and 53601 et seq. to invest non-HUD funds in the following:

Investment Type
Bonds (issued by the San Diego Housing Commission)
US Treasury Obligations (bills, bonds, or notes)
Registered state warrants, treasury notes/bonds (issued by the State of California)
Local Agency Investment Fund
US Agencies
Bankers' Acceptances (not to exceed 180 days)
Prime Commercial Paper (not to exceed 180 days)
Repurchase/Reverse Repurchase Agreements (2)
Medium Term Notes (rated "A" or better and not to exceed 5 years)
Negotiable Certificates of Deposit (1)
Money Market Mutual Funds
Trust Indentures/Contracts
Collateralized Bank Deposits
Mortgage Pass-Through Securities (not to exceed 5 years)

Footnotes:
(1) Deposits in excess of the insured amounts must be 100% collateralized.
(2) Securities purchased under these agreements shall be no less than 102% of the market value.
Source: San Diego Housing Commission Investment Policy

Interest Rate and Credit Risk

As of June 30, 2006, the Housing Commission's investments (in thousands) included the following:

Investment	Maturity Under 1 Year	Moody's Credit Rating	Fair Value (In Thousands)
State Local Agency Investment Fund	$ 478	Not Rated	$ 478
Total Investments - San Diego Housing Commission			$ 478

At June 30, 2006, the Housing Commission did not have any debt investments that are highly sensitive to changes in interest rates.

Custodial Credit Risk

At June 30, 2006, the Housing Commission did not have any investments exposed to custodial credit risk. All investments are held by the State of California or a pledging financial institution in the name of the Commission.

4. CAPITAL ASSETS (In Thousands)

Capital asset activity for the year ended June 30, 2006 was as follows:

	Primary Government				
	Beginning Balance	Increases	Decreases/ Adjustments	Transfers	Ending Balance
GOVERNMENTAL ACTIVITIES:					
Non-Depreciable Capital Assets:					
Land, Easements, Rights of Way	$ 1,696,804	$ 7,126	$ (1,615)	$ 8,749	$ 1,711,064
Construction in Progress	223,519	113,796	(2,676)	(110,736)	223,903
Total Non-Depreciable Capital Assets	1,920,323	120,922	(4,291)	(101,987)	1,934,967
Depreciable Capital Assets:					
Structures and Improvements	998,552	7,807	(889)	39,559	1,045,029
Equipment	375,748	18,614	(20,467)	345	374,240
Infrastructure	2,779,795	20,326	(237)	63,430	2,863,314
Total Depreciable Capital Assets	4,154,095	46,747	(21,593)	103,334	4,282,583
Less Accumulated Depreciation For:					
Structures and Improvements	(233,321)	(27,199)	889	(240)	(259,871)
Equipment	(252,076)	(29,504)	18,660	(349)	(263,269)
Infrastructure	(1,304,612)	(82,190)	32	-	(1,386,770)
Total Accumulated Depreciation	(1,790,009)	(138,893)	19,581	(589)	(1,909,910)
Total Depreciable Capital Assets - Net of Depreciation	2,364,086	(92,146)	(2,012)	102,745	2,372,673
Governmental Activities Capital Assets, Net	$ 4,284,409	$ 28,776	$ (6,303)	$ 758	$ 4,307,640
BUSINESS-TYPE ACTIVITIES:					
Non-Depreciable Capital Assets:					
Land, Easements, Rights of Way	$ 85,618	$ 1,103	$ (3)	$ 3,051	$ 89,769
Construction in Progress	496,184	68,557	(4,169)	(161,150)	399,422
Total Non-Depreciable Capital Assets	581,802	69,660	(4,172)	(158,099)	489,191
Depreciable Capital Assets:					
Structures and Improvements	1,476,971	18,497	(564)	71,069	1,565,973
Equipment	311,618	6,149	(7,727)	6,075	316,115
Distribution & Collection Systems and Other Infrastructure	3,088,329	49,928	(12,466)	79,702	3,205,493
Total Depreciable Capital Assets	4,876,918	74,574	(20,757)	156,846	5,087,581
Less Accumulated Depreciation For:					
Structures and Improvements	(259,881)	(34,500)	555	3	(293,823)
Equipment	(184,230)	(23,331)	6,760	551	(200,250)
Distribution & Collection Systems and Other Infrastructure	(507,224)	(45,390)	6,287	(59)	(546,386)
Total Accumulated Depreciation	(951,335)	(103,221)	13,602	495	(1,040,459)
Total Depreciable Capital Assets - Net of Depreciation	3,925,583	(28,647)	(7,155)	157,341	4,047,122
Business-Type Activities Capital Assets, Net	$ 4,507,385	$ 41,013	$ (11,327)	$ (758)	$ 4,536,313

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Governmental Activities capital assets net of accumulated depreciation at June 30, 2006 are comprised of the following:

General Capital Assets, Net	$ 4,234,929
Internal Service Funds Capital Assets, Net	72,711
Total	$ 4,307,640

Business-Type Activities capital assets net of accumulated depreciation at June 30, 2006 are comprised of the following:

Enterprise Funds Capital Assets, Net	$ 4,536,034
Internal Service Funds Capital Assets, Net	279
Total	$ 4,536,313

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental Activities:

General Government and Support	$ 1,640
Public Safety - Police	5,491
Public Safety - Fire and Life Safety	4,052
Parks, Recreation, Culture and Leisure	31,512
Transportation	72,599
Sanitation and Health	514
Neighborhood Services	1,193
Subtotal	117,001
Internal Service (Except Special Engineering)	21,892
Total Depreciation Expense	$ 138,893

Business-Type Activities:

Airports	$ 468
City Store	1
Development Services	214
Environmental Services	6,604
Golf Course	670
Recycling	1,062
Sewer Utility	64,922
Water Utility	29,230
Subtotal	103,171
Internal Service (Special Engineering)	50
Total Depreciation Expense	$ 103,221

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Discretely Presented Component Units

Capital asset activities for the City's Discretely Presented Component Units for the year ended June 30, 2006 are as follows:

	Discretely Presented Component Unit - San Diego Convention Center Corp.				
	Beginning Balance	Increases	Decreases/ Adjustments	Transfers	Ending Balance
Depreciable Capital Assets:					
Structures and Improvements	$ 19,805	$ 5,026	$ (2,551)	$ (44)	$ 22,236
Equipment	9,113	734	(1,487)	44	8,404
Total Depreciable Capital Assets	28,918	5,760	(4,038)	-	30,640
Less Accumulated Depreciation For:					
Structures and Improvements	(7,539)	(1,437)	1,358	3	(7,615)
Equipment	(7,369)	(1,002)	2,161	(3)	(6,213)
Total Accumulated Depreciation	(14,908)	(2,439)	3,519	-	(13,828)
Capital Assets, Net	$ 14,010	$ 3,321	$ (519)	$ -	$ 16,812

	Discretely Presented Component Unit - San Diego Housing Commission				
	Beginning Balance	Increases	Decreases/ Adjustments	Transfers	Ending Balance
Non-Depreciable Capital Assets:					
Land, Easements, Rights of Way	$ 30,544	$ -	$ -	$ -	$ 30,544
Construction in Progress	8,637	1,306	-	-	9,943
Total Non-Depreciable Capital Assets	39,181	1,306	-	-	40,487
Depreciable Capital Assets:					
Structures and Improvements	83,145	-	-	-	83,145
Equipment	915	88	(17)	-	986
Total Depreciable Capital Assets	84,060	88	(17)	-	84,131
Less Accumulated Depreciation For:					
Structures and Improvements	(39,639)	(2,929)	-	-	(42,568)
Equipment	(862)	(25)	17	-	(870)
Total Accumulated Depreciation	(40,501)	(2,954)	17	-	(43,438)
Total Depreciable Capital Assets - Net of Depreciation	43,559	(2,866)	-	-	40,693
Capital Assets, Net	$ 82,740	$ (1,560)	$ -	$ -	$ 81,180

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5. GOVERNMENTAL ACTIVITIES LONG-TERM LIABILITIES (In Thousands)

a. Long-Term Liabilities

Governmental long-term liabilities as of June 30, 2006 are comprised of the following:

Type of Obligation	Interest Rates	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2006
Compensated Absences				$ 71,820
Liability Claims				202,482
Capital Lease Obligations				40,541
Contracts Payable:				
Contract Payable to SDSU Foundation, dated December 1991	variable*	—	1,598	1,598
Amendment to Contract Payable to SDSU Foundation, dated January 1995	variable*	—	117	117
Contract Payable to Western Pacific Housing, Inc. dated April 2004	5.00%	—	900	900
Total Contracts Payable				2,615
Notes Payable:				
Note Payable to Wal-Mart, dated June 1998	10.0%	2017	1,308	512
Notes Payable to San Diego Revitalization, dated April 2001	5.0	2032	5,115	4,682
Notes Payable to San Diego Revitalization, dated May 2005	8.0	2025	2,100	2,100
Total Notes Payable				7,294
Loans Payable:				
International Gateway Associates, LLC, dated October 2001	10.0	2032	1,876	1,838
North Park Theatre, LLC, dated December 2004	variable*	—	3,335	3,335
PCCP/SB Las America, LLC, dated August 2005	10.0	2036	1,247	1,247
Bud Fischer, dated March 2006	6.0	2007	2,679	2,679
Centerpoint, LLC, dated April 2006	7.0	2021	5,246	5,246
Total Loans Payable				14,345
San Diego Association of Governments (SANDAG) Loans Payable				7,355
Section 108 Loans Payable				42,499
General Obligation Bonds:				
Public Safety Communications Project, Series 1991	5.0 - 8.0**	2012	25,500	11,520
Open Space Park Refunding Bonds, Series 1994	5.0 - 6.0**	2009	64,260	1,170
Total General Obligation Bonds				12,690
Revenue Bonds / Lease Revenue Bonds / COPs:				
MTDB Authority Lease Revenue Refunding Bonds, Series 1994	4.25 - 5.625**	2010	66,570	10,240
Public Facilities Financing Authority Stadium Lease Revenue Bonds, Series 1996 A	6.2 - 7.45**	2027	68,425	60,490

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Type of Obligation	Interest Rates	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2006
San Diego Facilities and Equipment Leasing Corp. Certificates of Participation, Series 1996 A	4.0 - 5.6**	2011	$ 33,430	$ 15,440
San Diego Facilities and Equipment Leasing Corp. Certificates of Participation Refunding, Series 1996 B	4.0 - 6.0**	2022	11,720	9,180
Convention Center Expansion Financing Authority Lease Revenue Bonds, Series 1998 A	3.8 - 5.25**	2028	205,000	183,300
Centre City Parking Revenue Bonds, Series 1999 A	4.5 - 6.49**	2026	12,105	10,810
Public Facilities Financing Authority Reassessment District Refunding Revenue Bonds, Series 1999 A	2.75 - 4.75**	2018	30,515	17,315
Public Facilities Financing Authority Reassessment District Refunding Revenue Bonds, Series 1999 B	3.5 - 5.10**	2018	7,630	4,295
Public Facilities Financing Authority Ballpark Lease Revenue Bonds, Series 2002	7.15 - 7.7**	2032	169,685	167,560
Public Facilities Financing Authority Fire and Life Safety Lease Revenue Bonds, Series 2002 B	3.55 - 7.0**	2032	25,070	23,780
Centre City Parking Revenue Bonds, Series 2003 B	3.0 - 5.30**	2027	20,515	19,390
MTDB Authority Lease Revenue Refunding Bonds, Series 2003	2.0 - 4.375**	2023	15,255	14,050
San Diego Facilities Equipment Leasing Corp. Certificates of Participation Refunding, Series 2003	1.0 - 4.0**	2024	17,425	14,000
Total Revenue Bonds / Lease Revenue Bonds / COPs				549,850
Special Assessment / Special Tax Bonds:				
Otay Mesa Industrial Park Limited Obligation Improvement Bonds, Issued May 1992	5.5 - 7.95**	2013	2,235	395
Miramar Ranch North Special Tax Refunding Bonds, Series 1998	3.75 - 5.375**	2021	59,465	46,600
Santaluz Special Tax Bonds, Improvement Area No.1, Series 2000 A	4.75 - 6.375**	2031	56,020	54,545
Santaluz Special Tax Bonds, Improvement Area No.3, Series 2000 B	4.5 - 6.2**	2031	4,350	4,210
City of San Diego Reassessment District No. 2003-1 Limited Obligation Refunding Bonds	4.25 - 5.8**	2018	8,850	7,905
Piper Ranch Limited Obligation Improvement Bonds, Issued January 2004	2.5 - 6.2**	2034	5,430	5,195
Santaluz Special TaxBonds, Improvement Area No.1, Series 2004 A	1.7 - 5.5**	2031	5,000	4,885
Santaluz Special TaxBonds, Improvement Area No.4, Series 2004 A	1.65 - 5.5**	2034	9,965	9,870
Total Special Assessment / Special Tax Bonds				133,605

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Type of Obligation	Interest Rates	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2006
Tax Allocation Bonds:				
Gateway Center West Redevelopment Project Tax Allocation Bonds, Series 1995	7.8 - 9.75**	2014	$ 1,400	$ 815
Mount Hope Redevelopment Project Tax Allocation Bonds, Series 1995 A	4.4 - 6.0**	2020	1,200	880
Mount Hope Redevelopment Project Tax Allocation Bonds, Series 1995 B	6.9 - 8.2**	2021	3,955	3,200
Southcrest Redevelopment Project Tax Allocation Bonds, Series 1995	4.75 - 6.592**	2020	3,750	2,455
Horton Plaza Redevelopment Project Tax Allocation Refunding Bonds, Series 1996 A	3.8 - 6.0**	2016	12,970	8,395
Horton Plaza Redevelopment Project Tax Allocation Refunding Bonds, Series 1996 B	4.3 - 7.0**	2007	9,830	410
Centre City Redevelopment Tax Allocation Bonds, Series 1999 A	3.0 - 5.125**	2019	25,680	25,320
Centre City Redevelopment Tax Allocation Bonds, Series 1999 B	6.25**	2014	11,360	11,360
Centre City Redevelopment Tax Allocation Bonds, Series 1999 C	3.1 - 4.75**	2025	13,610	12,405
City Heights Redevelopment Tax Allocation Bonds, Series 1999 A	4.5 - 5.8**	2029	5,690	5,455
City Heights Redevelopment Tax Allocation Bonds, Series 1999 B	5.75 - 6.4***	2029	10,141	9,825
Central Imperial Redevelopment Project Tax Allocation Bonds, Series 2000	4.45 - 6.6 9**	2031	3,395	3,160
Centre City Redevelopment Project Tax Allocation Bonds, Series 2000 A	4.0 - 5.6**	2025	6,100	5,345
Centre City Redevelopment Project Tax Allocation Bonds, Series 2000 B	3.95 - 5.35**	2025	21,390	19,670
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2000	4.25 - 5.8**	2022	15,025	14,425
North Bay Redevelopment Project Tax Allocation Bonds, Series 2000	4.25 - 5.875**	2031	13,000	11,920
North Park Redevelopment Project Tax Allocation Bonds, Series 2000	4.1 - 5.9**	2031	7,000	6,425
Southcrest Redevelopment Project Tax Allocation Bonds, Series 2000	4.45 - 6.5**	2026	1,860	1,670
Centre City Redevelopment Tax Allocation Bonds, Series 2001 A	4.93 - 5.55****	2027	58,425	57,175
Mount Hope Redevelopment Project Tax Allocation Bonds, Series 2002 A	5.0**	2027	3,055	3,055
Centre City Redevelopment Project Tax Allocation Bonds, Series 2003 A	2.5 - 5.0**	2029	31,000	21,755
City Heights Redevelopment Project Tax Allocation Bonds, Series 2003 A	5.875 - 6.5**	2034	4,955	4,955
City Heights Redevelopment Project Tax Allocation Bonds, Series 2003 B	2.5 - 4.25**	2014	865	625

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Type of Obligation	Interest Rates	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2006
North Park Redevelopment Project Tax Allocation Bonds, Series 2003 A	1.5 - 6.125**	2028	7,145	6,610
North Park Redevelopment Project Tax Allocation Bonds, Series 2003 B	4.75 - 5.0**	2034	5,360	5,360
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2003 A	4.65 - 5.1**	2022	6,325	6,325
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2003 B	3.25 - 5.45**	2022	4,530	4,530
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2003 C	3.49 - 7.74**	2022	8,000	7,460
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 A	3.5 - 5.25**	2030	101,180	99,670
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 B	2.26 - 4.58**	2011	9,855	8,245
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 C	2.26 - 6.18**	2030	27,785	27,230
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 D	2.26 - 6.28**	2030	8,905	8,730
Centre City Redevelopment Project Tax Allocation Bonds, Series 2006 B	4.25-5.25**	2033	76,225	76,225
Centre City Redevelopment Project Tax Allocation Bonds, Series 2006 A	5.66-6.2**	2032	33,760	33,760
Total Tax Allocation Bonds				514,845
Tobacco Settlement Asset-Backed Bonds:				
Tobacco Settlement Revenue Funding Corporation Asset-Backed Bonds, Series 2006	7.125**	2023	105,400	105,400
Total Tobacco Settlement Asset-Backed Bonds				105,400
Total Bonds Payable				1,316,390
Net Pension Obligation				158,087
Total Governmental Activities Long-Term Liabilities				$ 1,863,428

* Additional information on the variable rate contracts payable with the SDSU Foundation and loans payable with North Park Theatre, LLC are discussed further on the following page.

** Interest rates are fixed, and reflect the range of rates for various maturities from the date of issuance to maturity.

*** The City Heights Redevelopment Tax Allocation Bonds, Series 1999 B, are capital appreciation bonds, which mature from fiscal year 2011 through 2029. The balance outstanding at June 30, 2006 does not include accreted interest of $5,342.

**** The Centre City Redevelopment Tax Allocation Bonds, Series 2001 A, partially include capital appreciation bonds, which mature from fiscal year 2015 through 2027. The balance outstanding at June 30, 2006 does not include accreted interest of $3,877.

Liability claims are primarily liquidated by the Self Insurance Fund and Enterprise Funds. Compensated absences are paid out of the operating funds and certain internal service funds. Pension liabilities are paid out of the operating funds based on a percentage of payroll.

Public safety general obligation bonds are secured by a pledge of the full faith and credit of the City or by a pledge of the City to levy ad valorem property taxes without limitation. Open space general obligation bonds are backed by Environmental Growth Fund 2/3 franchise fees.

Revenue bonds are secured by a pledge of specific revenue generally derived from fees or service charges related to the operation of the project being financed. Certificates of Participation (COPs) and lease revenue bonds provide long-term financing through a lease agreement, installment sales agreement, or loan agreement that does not constitute indebtedness under the state constitutional debt limitation and is not subject to other statutory requirements applicable to bonds.

Special assessment/special tax bonds are issued by the City to provide funds for public improvements in/and or serving special assessment and Mello-Roos districts created by the City. The bonds are secured by assessments and special taxes levied on the properties located within the assessment districts and the community facilities districts, and are payable solely from the assessments and special taxes collected. The assessments and the special taxes, and any bonds payable from them, are secured by a lien on the properties upon which the assessments and the special taxes are levied. Neither the faith and credit nor the taxing power of the City is pledged to the payment of the bonds.

Section 108 loans are the loan guarantee provisions of the Community Development Block Grant (CDBG) program. Section 108 loans provide the community with a source of financing for economic development, housing rehabilitation, public facilities, and capital improvement and infrastructure projects.

SANDAG loans are comprised of two components: repayment of debt service on bonds, and repayment of proceeds from commercial paper. The City receives distributions of SANDAG bond proceeds, based on the City's agreement with SANDAG. The annual debt service payments related to these bond issuances are recovered by SANDAG through reductions in TransNet allocations that would otherwise be available for payment to the City. TransNet-Proposition A, was passed in 1987 to enact a ½ percent sales tax increase to fund regional transportation projects. All expenses must first be approved by SANDAG and be included on the Regional Transportation Plan (RTP). The City recognizes repayment of the principal and interest on bonds as an increase in TransNet revenues and an offsetting debt service expenditure. The interest rates on the outstanding bonds range from 4.75 percent to 5.50 percent. In addition to financing from bond issuances, financing for TransNet related projects is made available through the issuance of commercial paper notes by SANDAG, at the request of the City. Repayment of proceeds related to the commercial paper is collected in future periods through reductions in TransNet allocations, similar to the repayment of the debt service on bonds. Interest rates on commercial paper notes during the current year have varied from 2.40 percent to 3.58 percent, with maturities from 1 day to 166 days. Interest rates on outstanding commercial paper note amounts at June 30, 2006, ranged from 3.50 percent to 3.58 percent.

San Diego State University Foundation executed an Agreement for Processing a Redevelopment Plan and Land Use Entitlements with the Redevelopment Agency of the City of San Diego which allows for reimbursement of expenses incurred by the Foundation, in assisting in the preparation and processing of the Redevelopment Plan and Land Use Entitlements in the College Area. The agreement is a variable rate obligation of the Agency. The unpaid principal bears interest at the prime rate and is fixed on a quarterly basis, using the prime rate established on the first banking day of each calendar quarter. Interest calculations are made on the quarterly weighted average of the principal balance and are made at the end of the quarter based upon the rate fixed for that quarter. The interest rate is not to exceed 12 percent per annum on funds advanced to the Agency. The effective interest rate as of June 30, 2006 is 7.75 percent.

The Redevelopment Agency of The City of San Diego and North Park Theatre, LLC entered into a Disposition and Development Agreement dated April 23, 2002, a Second Implementation Agreement dated, April 28,2004 and a Third Implementation Agreement dated December 9, 2004. These agreements were executed for the purposes of effectuating the Redevelopment Plan for the North Park Redevelopment Project, by providing for the disposition of certain real property and a loan to the Agency from the Developer to fund the Agency's subsidy of the rehabilitation of the North Park Theatre building by the Developer. The Third Implementation Agreement converted the loan from a fixed rate to a variable rate obligation of the Agency. The interest on the loan is based on the prime rate plus 2 percent for the first two years, then will increase by a 1/2 percent per year for the remainder of the term of the loan. The interest rate shall not exceed the lesser of the Prime Rate plus four percent, or the maximum interest rate allowed by law. The interest rate shall be reset annually, on August 1st, based on the Prime Rate on the reset date. The effective interest rate as of June 30, 2006 is 8.25 percent.

b. Amortization Requirements

The annual requirements to amortize such long-term debt outstanding as of June 30, 2006, including interest payments to maturity, are as follows:

Year Ended June 30,	Capital Lease Obligations Principal	Capital Lease Obligations Interest	Contracts Payable Principal	Contracts Payable Interest	Notes Payable Principal	Notes Payable Interest
2007	$ 8,774	$ 1,510	$ -	$ -	$ -	$ -
2008	7,233	1,218	-	-	-	-
2009	6,474	938	-	-	-	-
2010	5,431	688	-	-	-	-
2011	4,067	487	-	-	-	-
2012-2016	8,562	527	-	-	-	-
Unscheduled*	-	-	2,615	1,713	7,294	4,144
Total	$ 40,541	$ 5,368	$ 2,615	$ 1,713	$ 7,294	$ 4,144

The contracts payable to SDSU Foundation in the amount of $1,715, the contract payable to Western Pacific Housing, Inc. in the amount of $900, and the notes payable to Wal-Mart of $512 and San Diego Revitalization of $6,782, do not have annual repayment schedules. Annual payments on the San Diego State University debt is based on the availability of tax increment net of the low-moderate and taxing agency set-asides as well as project area administration costs. Annual payments to the Wal-Mart, Western Pacific Housing, Inc., and San Diego Revitalization debt are based on available tax increment.

Year Ended June 30,	Loans Payable Principal	Loans Payable Interest	SANDAG Loans Principal	SANDAG Loans Interest	Section 108 Loans Principal	Section 108 Loans Interest	General Obligation Bonds Principal	General Obligation Bonds Interest
2007	$ 2,702	$ 385	$ 5,107	$ 225	$ 3,068	$ 2,340	$ 1,985	$ 783
2008	25	306	2,248	94	3,535	2,203	2,125	641
2009	27	304	-	-	2,364	2,046	2,265	502
2010	30	301	-	-	2,457	1,920	1,975	353
2011	33	298	-	-	2,595	1,783	2,100	219
2012-2016	224	1,433	-	-	15,066	6,415	2,240	74
2017-2021	361	1,295	-	-	9,443	2,424	-	-
2022-2026	581	1,076	-	-	3,971	421	-	-
2027-2031	935	722	-	-	-	-	-	-
2032-2036	846	185	-	-	-	-	-	-
Unscheduled*	8,581	242	-	-	-	-	-	-
Total	$ 14,345	$ 6,547	$ 7,355	$ 319	$ 42,499	$ 19,552	$ 12,690	$ 2,572

The loans payable to North Park Theatre, LLC in the amount of $3,335, and Centerpoint, LLC in the amount of $5,246 do not have annual repayment schedules. Annual payments are based upon future receipts of unallocated tax increment or other available sources.

Year Ended June 30,	Revenue Bonds / COPs Principal	Revenue Bonds / COPs Interest	Special Assessment / Special Tax Bonds Principal	Special Assessment / Special Tax Bonds Interest	Tax Allocation Bonds Principal	Tax Allocation Bonds Unaccreted Appreciation	Tax Allocation Bonds Interest	Tobacco Asset-Backed Bonds Principal	Tobacco Asset-Backed Bonds Interest
2007	$ 19,875	$ 32,416	$ 3,770	$ 7,286	$ 12,041	$ 1,910	$ 23,442	$ 2,700	$ 7,093
2008	20,860	31,437	4,045	7,112	13,371	1,996	24,746	3,300	7,317
2009	21,550	30,395	4,315	6,921	14,476	2,081	24,208	3,600	7,082
2010	21,235	29,337	4,630	6,709	15,088	2,163	23,555	3,800	6,826
2011	19,325	28,303	4,960	6,474	15,853	2,243	22,808	4,000	6,555
2012-2016	91,445	126,723	29,375	28,033	101,267	12,058	99,778	25,100	28,015
2017-2021	108,975	98,482	35,055	19,364	124,038	11,260	71,011	35,500	17,691
2022-2026	135,645	62,689	16,985	11,855	119,894	6,394	40,397	27,400	3,285
2027-2031	95,390	22,726	25,520	5,001	77,322	447	13,849		
2032-2036	15,550	1,155	2,950	260	21,495	-	1,166		
Subtotal	549,850	463,663	133,605	99,015	514,845	40,572	344,960	105,400	83,864
Add:									
Accreted Appreciation through June 30, 2006	-	-	-	-	9,219	-	-	-	-
Total	$ 549,850	$ 463,663	$ 133,605	$ 99,015	$ 524,064	$ 40,572	$ 344,960	$ 105,400	$ 83,864

** The Tobacco Asset-Backed Bond's Principal Debt Service requirements are based upon expected Turbo Principal payments.*

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c. Change in Long-Term Liabilities

Additions to governmental activities long-term debt for contracts, notes and loans payable may differ from proceeds reported on the Statement of Revenues, Expenditures, and Changes in Fund Balances, due to funding received in prior fiscal years being converted from short-term to long-term debt as a result of developers extending the terms of the obligation.

The following is a summary of changes in governmental activities long-term liabilities for the year ended June 30, 2006. The effect of bond accretion, bond premiums, discounts, and deferred amounts on bond refunds are amortized as adjustments to long-term liabilities.

	Governmental Activities				
	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Compensated Absences	74,387	50,878	(53,445)	71,820	31,064
Liability Claims	218,366	35,905	(51,789)	202,482	32,390
Capital Lease Obligations	30,647	20,087	(10,193)	40,541	8,774
Contracts Payable	1,715	900	-	2,615	-
Notes Payable	7,924	-	(630)	7,294	-
Loans Payable	5,187	9,171	(13)	14,345	2,702
Section 108 Loans Payable	42,858	2,151	(2,510)	42,499	3,068
SANDAG Loans Payable	13,979	1,651	(8,275)	7,355	5,107
General Obligation Bonds	14,530	-	(1,840)	12,690	1,985
Revenue Bonds / COPs	571,285	-	(21,435)	549,850	19,875
Unamortized Bond Premiums, Discounts and Deferred Amounts on Refunding	(950)	-	51	(899)	-
Net Revenue Bonds/COP's	570,335	-	(21,384)	548,951	19,875
Special Assessment / Special Tax Bonds	137,305	-	(3,700)	133,605	3,770
Unamortized Bond Premiums, Discounts and Deferred Amounts on Refunding	(654)	-	46	(608)	-
Net Special Assessment Bonds	136,651	-	(3,654)	132,997	3,770
Tax Allocation Bonds	415,778	109,985	(10,918)	514,845	12,041
Interest Accretion	7,463	1,822	(66)	9,219	
Balance with Accretion	423,241	111,807	(10,984)	524,064	12,041
Unamortized Bond Premiums, Discounts and Deferred Amounts on Refunding	3,215	2,408	-	5,623	-
Net Tax Allocation Bonds	426,456	114,215	(10,984)	529,687	12,041
Tobacco Settlement Asset-Backed Bonds:	-	105,400	-	105,400	2,700
Unamortized Bond Premiums, Discounts and Deferred Amounts on Refunding	-	-	-	-	-
Net Tobacco Settlement Asset-Backed Bonds	-	105,400	-	105,400	2,700
Net Pension Obligation	254,486	6,325	(102,724)	158,087	-
Total	$ 1,797,521	$ 346,683	$ (267,441)	$ 1,876,763	$ 123,476

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d. Defeasance of Debt

As of June 30, 2006, principal amounts payable from escrow funds established for defeased bonds are as follows:

Defeased Bonds	Amount
Horton Plaza Redevelopment Project Subordinate Tax Allocation Refunding Bonds, Series 1996 B	$ 6,640
Total Defeased Bonds Outstanding	$ 6,640

6. BUSINESS-TYPE ACTIVITIES LONG-TERM LIABILITIES (In Thousands)

a. Long-Term Liabilities

Business-type activities long-term liabilities as of June 30, 2006 are comprised of the following:

Type of Obligation	Interest Rates	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2006
Arbitrage Liability				$ 193
Compensated Absences				16,390
Liability Claims				50,379
Capital Lease Obligations				2,051
Loans Payable:				
Loans Payable to San Diego County Water Authority	-	-	100	100
Loans Payable to State Water Resources Control Board, issued February 9, 2000	1.80%**	2020	10,606	7,816
Loans Payable to State Water Resources Control Board, issued February 9, 2000	1.80**	2022	6,684	5,533
Loans Payable to State Water Resources Control Board, issued March 30, 2001	1.80**	2022	33,720	27,912
Loans Payable to State Water Resources Control Board, issued May 17, 2001	1.80**	2022	7,742	6,406
Loans Payable to State Water Resources Control Board, issued May 17, 2001	1.80**	2021	860	673
Loans Payable to State Water Resources Control Board, issued June 11, 2001	1.80**	2021	2,525	1,977
Loans Payable to State Water Resources Control Board, issued October 3, 2002	1.99**	2020	3,767	3,042
Loans Payable to State Water Resources Control Board, issued October 3, 2002	1.80**	2023	8,068	7,033
Loans Payable to State Water Resources Control Board, issued December 14, 2005	1.89**	2024	10,093	9,647
Loans Payable to Department of Health Services, issued July 6, 2005	2.5132	2026	21,525	21,108
Total Loans Payable				91,247
Bonds Payable:				
Sewer Revenue Bonds, Series 1993	2.8 - 5.25*	2023	250,000	182,370
Sewer Revenue Bonds, Series 1995	3.9 - 6.0*	2025	350,000	284,505
Sewer Revenue Bonds, Series 1997 A	3.7 - 5.375*	2027	183,000	152,625

(continued on next page)

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Type of Obligation	Interest Rates	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2006
Sewer Revenue Bonds, Series 1997 B	3.7 - 5.375*	2027	$ 67,000	$ 55,875
Water Certificate of Undivided Interest, Series 1998	4.0 - 5.375*	2029	385,000	271,055
Sewer Revenue Bonds, Series 1999 A	3.5 - 5.125*	2029	203,350	178,665
Sewer Revenue Bonds, Series 1999 B	3.5 - 5.125*	2029	112,060	98,665
Subordinated Water Revenue Bonds, Series 2002	2.0 - 5.0*	2033	286,945	286,945
Sewer Revenue Bonds, Series 2004	variable***	2008	152,000	152,000
Total Bonds Payable				1,662,705
Estimated Landfill Closure and Postclosure Care				14,811
Net Pension Obligation				36,394
Total Business-Type Activities Long-Term Liabilities				$ 1,874,170

** Interest rates are fixed, and reflect the range of rates for various maturities from the date of issuance to maturity.*
*** Effective rate*
**** Variable rate based on 62.34% of the London Inter-bank Offered Rate (LIBOR), which is a daily reference rate based on the interest rates at which major banks offer to lend unsecured funds to other banks in the London inter-bank market, plus 90 basis points through December 16, 2006. The effective interest rate at fiscal year end June 30, 2006 is 3.8984%.*

b. Amortization Requirements

Annual requirements to amortize long-term debt as of June 30, 2006, including interest payments to maturity, are as follows:

Year Ended June 30	Revenue Bonds Payable		Loans Payable		Capital Lease Obligations	
	Principal	Interest	Principal	Interest	Principal	Interest
2007	$ 56,845	$ 80,721	$ 4,677	$ 1,802	$ 1,045	$ 69
2008	74,015	77,795	4,767	1,712	840	31
2009	75,995	74,606	4,860	1,619	166	4
2010	77,985	71,404	4,956	1,523		
2011	80,210	67,972	5,052	1,427	-	-
2012-2016	305,245	292,865	26,783	5,612	-	-
2017-2021	369,745	211,023	28,624	2,883	-	-
2022-2026	398,920	109,321	11,428	533	-	-
2027-2031	197,600	25,353	-	-	-	-
2032-2036	26,145	1,324	-	-	-	-
Unscheduled *	-	-	100	-	-	-
Total	$ 1,662,705	$ 1,012,384	$ 91,247	$ 17,111	$ 2,051	$ 104

** The loan payable to the San Diego County Water Authority in the amount of $100 does not have an annual repayment schedule. The payment is due if funding for the projects for which the loan was received becomes available from other sources.*

c. Change in Long-Term Liabilities

The following is a summary of changes in long-term liabilities for the year ended June 30, 2006. The effect of bond premiums, discounts and deferred amounts on refunding are reflected as adjustments to long-term liabilities.

	Business-Type Activities				
	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Arbitrage Liability	$ 213	$ 3	$ (23)	$ 193	$ -
Compensated Absences	17,521	12,974	(14,105)	16,390	7,580
Liability Claims	47,389	4,551	(1,561)	50,379	3,524
Capital Lease Obligations	3,521	-	(1,470)	2,051	1,045
Loans Payable	63,803	31,618	(4,174)	91,247	4,677
Revenue Bonds Payable	1,698,060	-	(35,355)	1,662,705	56,845
Unamortized Bond Premiums, Discounts and Deferred Amounts on Refunding	(8,510)	-	751	(7,759)	-
Net Revenue Bonds Payable	1,689,550	-	(34,604)	1,654,946	56,845
Estimated Landfill Closure and Postclosure Care	13,665	1,146	-	14,811	-
Net Pension Obligation	35,104	2,264	(974)	36,394	-
Total	$ 1,870,766	$ 52,556	$ (56,911)	$ 1,866,411	$ 73,671

d. Defeasance of Debt

As of June 30, 2006, principal amounts payable from escrow funds established for defeased bonds are as follows:

Defeased Bonds	Balance
Water Revenue Bonds, Series 1998	$ 77,155
Total Defeased Bonds Outstanding	$ 77,155

7. DISCRETELY PRESENTED COMPONENT UNITS LONG-TERM DEBT (In Thousands)

Discretely presented component units long-term debt as of June 30, 2006 is comprised as follows:

San Diego Convention Center Corporation

Type of Obligation	Interest Rate	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2006	Due Within One Year
Compensated Absences				$ 1,121	$ 1,076
Capital Lease			3,942	3,662	706
Note Payable to San Diego Unified Port District, dated 1999	0.00%	2011	10,000	4,500	1,000
Total Long-Term Liabilities				9,283	2,782

000598

Annual requirements to amortize long-term debt as of June 30, 2006, are as follows:

Capital Lease		Note Payable	
Fiscal Year	Amount	Fiscal Year	Amount
2007	$ 706	2007	$ 1,000
2008	755	2008	1,000
2009	807	2009	1,000
2010	863	2010	1,000
2011	531	2011	500
Total	$ 3,662	Total	$ 4,500

San Diego Housing Commission

Type of Obligation	Interest Rate	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2006	Due Within One Year
Compensated Absences				$ 1,391	$ 1,391
Note Payable to Bank of America, dated February 1985	5.0 – 10.2%	2025	3,789	3,077	103
Note Payable to Ciy of San Diego Redevelopment Agency, dated March 1992	0.0	2022	696	696	-
Note Payable to Washington Mutual, dated June 1995	Variable*	2011	4,725	3,672	169
Note Payable to State of California (RHCP)	3.0	2013	3,149	3,149	-
Note Payable to State of California (RHCP)	0.0	2015	1,405	1,405	-
Note Payable to State of California (CalHELP)	0.0	2013	704	1,892	-
Total Notes Payable				$ 15,282	$ 1,663

* The interest rate as of June 30, 2006 was 4.31%

Annual requirements to amortize such long-term debt as of June 30, 2006 to maturity are as follows:

Year Ending June 30	Principal	Interest
2007	$ 272	$ 313
2008	289	295
2009	302	283
2010	314	271
2011	3,001	257
2012-2016	7,211	1,772
2017-2021	957	312
2022-2025	1,545	62
Total	$ 13,891	$ 3,565

8. SHORT-TERM NOTES PAYABLE (In Thousands)

The City issues Tax and Revenue Anticipation Notes (TRANs) in advance of property tax collections, depositing the proceeds into the General Fund. These notes are necessary to meet the cash requirements of the City prior to the receipt of property taxes.

Short-term debt activity for the year ended June 30, 2006, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Tax and Revenue Anticipation Notes	$ -	$ 145,000	$ (145,000)	$ -

The $145,000 FY06 TRANs issue had an average interest rate of 3.19% and was repaid on May 31, 2006.

9. JOINT VENTURE and JOINTLY GOVERNED ORGANIZATIONS (In Thousands)

San Diego Medical Services Enterprise, LLC

A joint venture is a legal entity or other organization that results from a contractual arrangement and that is owned, operated, or governed by two or more participants as a separate and specific activity subject to joint control. San Diego Medical Services Enterprise, LLC (SDMSE) is a joint venture that is reported within the General Fund.

SDMSE was organized on May 2, 1997 to provide emergency medical services and medical transportation services to the citizens of San Diego. Operations began July 1, 1997 under an initial 5 year agreement that was extended on July 1, 2002 and again on July 1, 2005 for an additional three year period. The SDMSE partners are the City of San Diego and Rural Metro of San Diego, Inc., a wholly owned subsidiary of Rural Metro Corporation (a publicly traded corporation). The SDMSE governing board is comprised of five members, three of whom are appointed by the City. In accordance with GASB 14, the financial impacts of the joint venture are reported in the General Fund.

The maximum funds which the City is required to contribute to the costs of SDMSE operations are limited to an aggregate of $8,450 during the term of the third amended agreement. This aggregate includes a $650 annual subsidy and any other amounts to be paid to the City since 1997 under the original contract, and any losses the City is required to cover under the extended contract, excluding any amount the City contributes for Medicare fee reimbursements. Cumulatively, the City has paid annual subsidies totaling $5,700 as of June 30, 2006. Effective in fiscal year 2006, the City is no longer required to pay the $650 annual subsidy and the Medicare fee reimbursements shall not exceed $250 per fiscal year. Net assets of SDMSE are pro-rated to each partner based on a 50/50 split. In accordance with the operating agreement, profit and loss for each fiscal year is allocated equally to the members, subject to an aggregate limitation on loss to the City of $8,450 (equal to the amount of subsidies discussed above). For the fiscal year ended June 30, 2006, SDMSE reported a net income of $1,499, a member distribution of $455, and ending net assets of $4,127.

Under the terms of an operating agreement between Rural/Metro of San Diego, Inc. and SDMSE, Rural/Metro of San Diego, Inc. has made available a line-of-credit in the initial amount of $3,500 bearing an interest rate of 9.5%. SDMSE did not have an outstanding balance, nor did it borrow on the line-of-credit at June 30, 2006.

Complete financial statements can be requested from San Diego Medical Services Enterprise, LLC, 8401 East Indian School Rd., Scottsdale, Arizona 85251.

San Diego Workforce Partnership

The City of San Diego and the County of San Diego jointly govern the San Diego Workforce Partnership (Consortium). The Consortium's Board of Directors consists of two members of the City Council, two members from the County Board of Supervisors, and one member of a charitable organization. The purpose of the Consortium is to provide regional employment and training services in order to develop and create job opportunities throughout San Diego County.

San Diego Geographic Information Source (SanGIS)

SanGIS was created in July 1997 as a joint powers agreement between the City of San Diego and the County of San Diego. SanGIS objectives are to create and maintain a geographic information system, marketing and licensing compiled digital geographic data and software, providing technical services and publishing geographical and land-related information.

10. LEASE COMMITMENTS (In Thousands)

The City leases various properties and equipment. Leased property having elements of ownership are recorded as capital leases and reported as capital assets in the government-wide financial statements, along with a corresponding capital lease obligation. Leased property that does not have elements of ownership is reported as an operating lease and is expensed when paid.

Operating Leases

The City's operating leases consist primarily of rental property occupied by City departments. The following is a schedule of future minimum rental payments required under operating leases entered into by the City for property that has initial or remaining non-cancelable lease terms in excess of one year as of June 30, 2006:

Year Ended June 30	Amount
2007	$ 11,699
2008	11,167
2009	11,396
2010	11,078
2011	10,524
2012-2016	27,442
2017-2021	245
2022-2026	147
Total	$ 83,698

Rent expense as related to operating leases was $12,259 for the year ended June 30, 2006.

Capital Leases

The City has entered into various capital leases for equipment, vehicles and property. These capital leases have maturity dates ranging from July 1, 2006 through November 30, 2014, and interest rates ranging from 2.57% to 7.94%. A schedule of future minimum lease payments under capital leases as of June 30, 2006 is provided in Notes 5 and 6. The value of all capital leased assets as of June 30, 2006 for governmental assets is $32,850, net of accumulated depreciation of $79,249 and business-type assets of $12,619 net of accumulated depreciation of $12,761.

Lease Revenues

The City has operating leases for certain land, buildings and facilities with tenants and concessionaires. Leased capital asset carrying values of approximately $45,672 as well as depreciation are reported in Note 4 and are consolidated with non-leased assets. Minimum annual lease revenues are reported in the following schedule:

Year Ended June 30		Amount
2007	$	28,540
2008		27,262
2009		26,661
2010		26,026
2011		25,767
2012-2016		121,799
2017-2021		110,250
2022-2026		103,007
2027-2031		97,531
2032-2036		87,577
2037-2041		80,145
2042-2046		69,584
2047-2051		32,968
2052-2056		6,958
2057-2061		2,375
Total	$	846,450

This amount does not include contingent rentals which may be received under certain leases of property on the basis of percentage returns. Rental income as related to operating leases was $72,822 for the year ended June 30, 2006 which includes contingent rentals amounting to $44,900.

11. DEFERRED COMPENSATION PLAN (In Thousands)

The City, San Diego Convention Center Corporation (SDCCC), San Diego Data Processing Corporation (SDDPC), and San Diego Housing Commission (SDHC) each offer their employees a deferred compensation plan, created in accordance with Internal Revenue Service Code Section 457, State and Local Government Deferred Compensation Plans. These plans, available to eligible employees, permit them to defer, pre-tax, a portion of their salary until future years. Deferred compensation is not available to employees until termination, retirement, death, disability or an unforeseeable emergency. All assets and income of the deferred compensation plan are held in trust for the exclusive benefit of plan participants and their beneficiaries. The deferred compensation plans are not considered part of the City of San Diego's financial reporting entity.

12. PENSION PLANS (In Thousands)

The City has a defined benefit pension plan and various defined contribution pension plans covering substantially all of its employees.

DEFINED BENEFIT PLAN

a. **Plan Description**

San Diego City Employees' Retirement System ("SDCERS"), as authorized by Article IX of the City Charter, is a public employee retirement system established in fiscal year 1927 by the City. SDCERS is an agent multiple-employer defined benefit public pension plan and acts as a common investment and administrative agent for the City, the San Diego Unified Port District (the "Port"), and the San Diego County Regional Airport Authority (the "Airport"). It is administered by the SDCERS Board (the "Board") to provide retirement, disability, death and survivor benefits for its members. Amendments to the City's benefit provisions require City Council approval as well as a majority vote by members, provided that benefit increases also require a majority vote of the public (effective January 1, 2007). All approved benefit changes are codified in the City's Municipal Code.

The Defined Benefit Plan (the Plan) covers all eligible employees of the City, the Port, and the Airport. All City employees working half-time or greater and full-time employees of the Port and the Airport, are eligible for membership and are required to join SDCERS. The Port and Airport are not component units of the City CAFR, however, and the information herein relates solely to the City's participation in SDCERS. City employment classes participating in the Plan are elected officers, general and safety (including police, fire and lifeguard members). These classes are represented by various unions depending on the type and nature of work performed, except for elected officials, unclassified and unrepresented employees.

Plan Membership as of June 30, 2006

	General	Safety	Total by Classification
Active Members	6,409	2,478	8,887
Terminated Members	1,983	376	2,359
Retirees, Disabled and Beneficiaries	3,800	2,601	6,401
Total Members, as of June 30, 2006	12,192	5,455	17,647

Source: SDCERS-City of San Diego Actuarial Valuation as of June 30, 2006

As a defined benefit plan, retirement benefits are determined primarily by a member's class, age at retirement, number of years of creditable service, and the member's final compensation based on the highest salary earned over a consecutive one-year period. The Plan provides cost of living adjustments of 2% to retirees, which is factored into the actuarial assumptions. Increases in retirement benefits due to cost of living adjustments do not require voter approval. The Plan requires ten years of service at age 62, or 20 years of service at age 55 for general members (50 for safety members), which could include certain service purchased or service earned at a reciprocating government entity, to vest for a benefit. Typically, retirement benefits are awarded at a rate of 2.5% of the employee's one-year high annual salary per year of service at age 55 for general members, and 3% for Safety members starting at the age of 50. The actual percentage of final average salary per year served component of the calculation rises as the employee's retirement age increases and depends on the retirement *option selected by the employee. General plan percentage of final average salary per year served is a maximum* of 2.8% for general members and 3% for safety members.

Deferred Retirement Option Program (DROP)

The City also has a Deferred Retirement Option Program (DROP) where participants continue to work for the City and receive a regular paycheck. SDCERS' members electing to participate in DROP must agree to participate in the program for a specific period, up to a maximum of five years. A DROP participant must agree to end employment with the City on or before the end of the selected DROP participation period. A SDCERS member's decision to enter DROP is irrevocable.

Upon entering the program, the DROP participant stops making contributions to SDCERS and stops earning creditable service. Instead, amounts equivalent to the participant's retirement benefit plus 8% earnings and additional contributions are credited to an individual account held in the participant's name. The DROP benefit is the value of a DROP participant's account at the end of the DROP participation period. Participants select the form of the distribution of the DROP account when they leave employment and begin retirement. The distribution is made as a single lump sum or in 240 equal monthly payments, or as otherwise allowed by applicable provisions of the Internal Revenue Code. Outstanding liabilities for DROP are shown on the Statement of Fiduciary Net Assets in the basic financial statements. During the period of participation, the participant continues to receive most of the employer offered benefits available to regular employees.

SDCERS' members who were hired on or after July 1, 2005 are ineligible to participate in the DROP program due to the benefit changes negotiated with the July 1, 2005 Memoranda of Understanding (MOU). However, SDCERS has asserted that due to delays in codification of benefit changes into the Municipal Code, the effective cut off date would instead be February 16, 2007, which is when the Ordinance O-19567 was officially codified in the Municipal Code. As of the issuance of this report, the City Attorney and SDCERS legal counsel do not agree on this issue and the Municipal Code states July 1, 2005 as the effective date [refer to Note 18 for additional information]. Notwithstanding amendments to the municipal code, SDCERS' members who were hired prior to July 1, 2005 are eligible to participate in DROP when they are eligible for a service retirement.

Purchase of Service Credits

Article 4 Division 13 of the City's Municipal Code allows plan members to purchase years of Creditable Service for use in determining retirement allowances. To purchase Creditable Service, a Member must elect to pay and thereafter pay, in accordance with such election before retirement, into the Retirement Fund an amount, including interest, determined by the Board. No Member will receive Creditable Service under this Division for any service for which payment has not been completed pursuant to this Division before the effective date of the Member's retirement. The City Attorney has opined that in the past, the Purchase of Service Credits were under priced by the Board of Administration. After review of the purchase of service program, SDCERS' actuary concluded that the service credit pricing structure that was in place prior to November 2003 did not reflect the full cost in the price then charged to SDCERS members. The pricing shortfall of approximately $146,000, which is included in the UAAL, is reported in the RSI of these financial statements. The service credit pricing structure used after November 2003, however, does cover the full projected cost to the System when members purchased the service credits (this is discussed in Note 18: Contingencies).

SDCERS' members who were hired on or after July 1, 2005 are ineligible to participate in the Purchase of Service Credit program due to the benefit changes negotiated with the July 1, 2005 Memoranda of Understanding (MOU). However, SDCERS has asserted that due to delays in codification of benefit changes into the municipal code, the effective cut off date would instead be February 16, 2007, which is when the Ordinance O-19567 was officially codified in the Municipal Code. As of the issuance of this report, the City Attorney and SDCERS legal counsel do not agree on this issue and the Municipal Code states July 1, 2005 as the effective date [refer to Note 18 for additional information]. Notwithstanding amendments to the municipal code, SDCERS' members who were hired prior to July 1, 2005 are eligible to participate the Purchase of Service Credit Program.

Corbett Settlement Benefits and Retirement Factors

In 1998, a lawsuit was filed by retired employees who alleged that the City's definition of compensation subject to the computation of retirement benefits improperly excluded the value of certain earnings. The City and SDCERS settled in May of 2000, which is known as the Corbett Settlement. This settlement provided for a flat increase of

7% in benefits payable to eligible members who retired prior to July 1, 2000, payable annually. The settlement also provided a 10% benefit increase and allows for two options in calculating the service retirement allowance for employees active at the time of the settlement and who joined the Retirement System before July 1, 2000 and who retired after July 1, 2000.

The options for calculating the service retirement allowance are outlined in the San Diego Municipal Code sections 24.0402 and 24.0403 which can be obtained at City of San Diego City Clerks Office 202 C Street, San Diego, CA 92101 or online at www.sandiego.gov.

On July 1, 2002 the City Council increased the retirement factors used for calculating retirement allowances; this action was related to MP-2 (as discussed later in this note). As a result of the Corbett Settlement and other benefit actions taken by the City Council, the service retirement factors for general members (non-safety and non-legislative) range from 2.0% at age 55 to 2.8% at age 65. The service retirement factors for Safety Members (Fire, Police and Lifeguard) range from 2.2% at age 50 to 3.0% at age 50 depending on the Corbett Settlement option selected. Finally, the City also maintains an Elected Officer's Retirement Plan where members are eligible to receive 3.5% of their final average salary per year of creditable service. Depending on the number of years serviced, participants of the Elected Officer's Retirement plan can retire earlier than the age of 55, however, their retirement allowance is reduced by 2.0% for each year under the age of 55.

Preservation of Benefit Plan

On March 19, 2001, the City Council adopted Ordinance O-18930, adding SDMC sections 24.1601 through 24.1608, establishing the Preservation of Benefit Plan (POB Plan). The POB Plan is a qualified governmental excess benefit arrangement (QEBA) under Internal Revenue Code (IRC) section 415(m), which was created by Congress to allow the payment of promised pension benefits that exceed the IRC section 415(b) limits (and therefore cannot be paid from a qualified retirement plan). As provided, in SDMC section 24.1606, and required by federal tax law, the POB Plan is unfunded within the meaning of the federal tax laws. The City may not pre-fund the POB Plan to cover future liabilities beyond the current year as it can with an IRC section 401(a) pension plan. SDCERS has established procedures to pay for these benefits on a pay-as-you-go basis. Currently, SDCERS is participating in a Voluntary Correction Program with the IRS concerning the POB plan (refer to Note 18: Contingencies for additional information). As of issuance of this report, actuarial liabilities related to retired member benefits that exceeded §415 limits are included in the RSI for the City's core pension plan for valuation years up to and including fiscal year 2005. In the fiscal year 2006 actuarial valuation, the estimated actuarial accrued liability related to excess benefits for eligible active members of the system, amounting to approximately $22,800, was removed from the plan's Actuarial Liabilities (this liability is estimated to be approximately $30,400 in the fiscal year 2007 actuarial valuation). Additionally, the liability for retired members of the POB Plan, amounting to approximately $6,400, has been excluded from the fiscal year 2007 actuarial valuation. Estimates related to the actuarial liability for benefits that exceed IRS §415 limits were calculated using actuarial assumptions consistent with those used to perform actuarial valuations for the City's core pension plan and also pursuant to the Compliance Statement, dated December 20, 2007, and Tax Determination Letter provided by the IRS during Voluntary Correction Program discussions.

The most current estimates related to the Preservation of Benefit plan are that approximately 58 beneficiaries have received benefits of approximately $2,900 in excess of IRC §415 limits through June 30, 2006; an additional approximate $900 in benefits were paid in the fiscal year ending June 30, 2007 for an estimated cumulative overpayment of $3,800. No additional plan payments or repayments are required as a result of the Compliance Statement. The number of plan participants, in any given year, for the Preservation of Benefit Plan is determined by the number of plan participants who exceed the current year's IRS §415(b) limitations as calculated by SDCERS' actuary. The maximum limit for the calendar year 2006 was $175 (calendar year 2008 limit is $185) and is adjusted downward depending on the age of the participant when benefits began.

Charter Amendment

On November 7, 2006, the citizens approved an amendment to Article 9, Section 143 of the City's Charter, requiring voter approval of certain increases in retirement system benefits for public employees. Specifically, this amendment requires a majority approval of any ordinance that amends the City's retirement system by increasing the benefits of any employee.

Additional details of retirement benefits can be obtained from SDCERS. SDCERS is considered part of the City of San Diego's financial reporting entity and is reported as a pension trust fund. SDCERS issues stand-alone financial statements which are available at its office located at 401 West A Street, Suite 400, San Diego, California 92101.

b. **Summary of Significant Accounting Policies – Pension**

Basis of Accounting - The pension trust fund uses the economic resources measurement focus and the accrual basis of accounting. Contributions are recognized as additions in the period in which the contributions are due and a formal commitment to provide the contributions has been made. Benefits and refunds are recognized when due and payable in accordance with the Plan.

Method Used to Value Investments - SDCERS investments are stated at fair value. The SDCERS custodial agent provides market values of invested assets with the exception of the fair value of directly owned real estate assets which are provided by the responsible investment manager and independent third party appraisal firms. Investment income is recognized in accordance with GASB 25 and is stated net of investment management fees and related expenses.

c. **Contributions and Reserves - Disclosure Related to Long - Term Contracts and Other Agreements**

Funding Contracts: MP-1 and MP-2

The City employer contributions for fiscal years 1996 - 2003 were not based on the full actuarial rates. Instead, employer contributions were less than the full actuarial rates in accordance with an agreement between the City and SDCERS, commonly referred to as Manager's Proposal 1 (MP-1). MP-1 provided that the City would make annual payments according to a contractually fixed formula of increasing percentages of total payroll instead of annual payments based on the annually required contribution (ARC) rates determined by the actuary. This agreement was subject to an actuarially determined funding ratio ("the trigger") of 82.3%. In the event the trigger was reached, the City would be required to make a lump sum payment to return the system to the funding ratio of 82.3%. The funding provision established by MP-1 was to be effective until fiscal year 2007, at which time, the City's contribution would return to the full ARC rate determined by the actuary. In the opinion of Kroll (a professional consulting firm engaged by the City to act in the capacity of an Audit Committee) and the City Attorney, the funding mechanism of MP-1 was illegal in violation of the City Charter and the State Constitution.

In 2002, a second agreement between the City and SDCERS was ratified; this agreement subsequently became known as Manager's Proposal 2 (MP-2). MP-2 modified MP-1 principally by allowing the City to avoid a balloon payment if the trigger was reached. Instead, MP-2 allowed the City to increase its funding until the full ARC was reached. This provision of MP-2 required that funding be increased over a five year period. In the opinion of Kroll and the City Attorney, the funding mechanism of MP-2 was illegal in violation of the City Charter and the State Constitution.

The actuarial valuation as of June 30, 2002, received in January 2003, which applies to contributions made in fiscal year 2004, reported the funded ratio to be 77.3%, thus the trigger had been breached. As a result, the City paid the increased contribution rates (which were less than the full actuarial rates) as required by MP-2 in the next fiscal year (fiscal year ended June 30, 2004). MP-1 and MP -2 are no longer in effect due to the Gleason settlement (see the section titled "Funding Commitments Related to Legal Settlements" in this Note).

A discussion of funding levels can be found in the Funding Policy and Annual Pension Cost section of this note.

Funding Contracts: Union Agreements

The City has historically picked up a portion of the employee's retirement contributions. The fiscal year 2006 MOUs and the changes to current and future employee benefits therein were introduced to Council in November 2006, and the changes in benefit eligibility were approved by Council Resolution 300600.

The agreement in the MOUs (agreements with the police union were not reached) was to reduce the amount of individual employees' pension contributions which are paid for by the City, effective fiscal year 2006. The agreements with labor unions resulted in the reduction of City "pick-up" of the employee pension contribution by 3% for the Municipal Employees' Association (MEA), the International Association of Fire Fighters Local 145, and the Deputy City Attorney Association (DCAA) and a unilaterally imposed reduction of 3.2% for the San Diego Police Officers Association (POA). In addition, the American Federation of State and County Municipal Employees (AFSCME) Local 127 negotiated a 1.9% salary reduction in lieu of a City "pick up" contribution reduction and a benefit freeze.

The agreements with the bargaining units explicitly indicate that savings to the City must be used to help address its Unfunded Actuarial Accrued Liability (UAAL) within the timeframe of the respective contracts. The labor contract with Local 127 states that "By June 30, 2008, if the City has not dedicated a total of $600,000 or more to the UAAL reduction, including the amount received by leveraging employee salary reduction and pension contribution monies, the AFSCME salary reduction monies with interest will revert to SDCERS Employee Contribution Rate Reserve for benefit of Local 127 unit members to defray employee pension contributions." The City will be excused from meeting the above obligation if the funded ratio reaches 100% by June 30, 2008.

In June 2006, the City leveraged a portion of the employee pick up savings by contributing $90,800 from securitization of future tobacco settlement revenues, $9,200 of current tobacco settlement revenues, and $8,300 from the remaining balance in the employee "pick-up" amount as part of meeting its negotiated commitment. The $100,000 payment in excess of the ARC from tobacco settlement revenues is 100% backed by general fund revenues, and therefore, was directly allocated to reduce the NPO of the general fund only. The additional contribution of $8,300 in excess of the ARC, however, was allocated Citywide as a reduction to the NPO. In June 2007, the City contributed approximately $7,000 in addition to the ARC, from the savings of the employee "pick-up" reduction. (These agreements are also discussed in the Subsequent Events Note 22). A financing option to generate additional funding is currently being pursued. As of issuance of this report, it appears the City will not be able to meet the outstanding commitment by June 30, 2008 in its entirety. As such, the salary reduction monies, with interest, will likely revert to the employee contribution rate reserve as stated in the MOU with the Local 127 bargaining unit.

Funding Commitments Related to Legal Settlements

Subsequent to the adoption of MP-2, the City settled a class action lawsuit regarding alleged breaches of fiduciary duty and law regarding the City's underfunding of the pension system resulting from the adoption of MP-1 and MP-2. The Gleason Settlement Agreement addressed the issues raised regarding the City's underfunding of the pension system by imposing the following requirements on the City for fiscal years 2005 through 2008:

1. Contribute $130,000 in fiscal year 2005. *
2. Pay its full ARC beginning fiscal year 2006.
3. Repeal Municipal Code Sections that legitimized the City's contribution obligations related to MP-2.
4. Provide a total of $375,000 of real property as collateral for payments required via the Gleason Settlement Agreement.

* The City's Gleason Settlement required contribution of $130,000 in fiscal year 2005 was paid prior to the execution of the agreement on July 7, 2005, and therefore, was omitted from the final agreement.

The Gleason Settlement also stipulated that certain actuarial assumptions be fixed, notably, that the amortization period was reset to a 29-year closed commencing with the June 30, 2004 Annual Actuarial Valuation. These assumptions were to remain in place for the duration of the settlement. On July 1, 2004, the City made the Gleason Settlement required contribution of $130,000 for fiscal year 2005 in addition to providing real property totaling $375,000 as collateral to be returned in annual installments of $125,000. On July 1, 2005, the City made the annually required contribution of $163,000 for fiscal year 2006. Additionally, the City made a contribution in excess of the ARC in the amount of $108,300 on June 30, 2006. On July 3, 2006 the City made its full annually required contribution of $162,000 as well as an additional $7,000 contribution in excess of the ARC for fiscal year 2007 and on July 1, 2007, the City made its full annually required contribution of $137,700 as well as an additional $27,300 contribution in excess of the ARC for fiscal year 2008. The final installment of $125,000 of real property collateral was returned to the City on November 9, 2007.

The annual required contributions for fiscal years 2005, 2006, and 2007 did not include the effects of the Corbett settlement because the SDCERS' Board viewed those benefits as contingent (see section a. for a description of the Corbett Settlement). Subsequent to those payments, the City determined that the Corbett Settlement liabilities are not contingent. As a result, the ARC for financial reporting was restated from the original ARC calculated by SDCERS' actuary to include Corbett Settlement liabilities. As a result, the City's NPO includes the effects of the Corbett Settlement.

In September 2006, the City entered into a settlement of McGuigan v. City of San Diego (the "McGuigan Settlement") related to the underfunding by the City of the pension system. This agreement stipulated that the City pay $173,000 plus interest on amounts outstanding to SDCERS over a period of 5 years. An additional requirement of the McGuigan Settlement is that the City provides SDCERS real property collateral totaling $100,000 (Non-Depreciable Capital Assets – Land). These amounts are in addition to those required by the Gleason Settlement and are to be returned upon the full payment of the settlement.

As of the issuance of this report, the City has provided the real property collateral in addition to approximately $115,400 of additional payments to SDCERS, in an attempt to meet the terms of the McGuigan Settlement. The McGuigan Settlement was partially funded through the securitization of future tobacco revenue, transfers of actual tobacco revenue receipts, and additional employee "pick up" savings. This contribution is further discussed in the Funding Contracts: Union Agreements section above.

In January, 2006, the City reached a settlement on a separate civil action captioned: Newsome v. City of San Diego Retirement System, City of San Diego (the "Newsome Settlement"). As part of this settlement, the plaintiff has agreed to dismiss the lawsuit if the City provides an additional $100,000 in funding over five years to SDCERS or, the funding ratio of the City's retirement plan returns to 82.3%. The amounts stipulated in the Newsome settlement are in addition to the amount stipulated in the settlement of the McGuigan Settlement. Under the Newsome Settlement, if the City does not provide the additional funding, the plaintiff then has the right to re-file the lawsuit after giving the City 60 days notice.

d. **Funding Policy and Contribution Rates**

City Charter Article IX Section 143 requires employees and employers to contribute to the retirement plan. The Charter section, which was amended in fiscal year 2005, stipulates that funding obligations of the City shall be determined by the Board of SDCERS and are not subject to modification by the City. The section also stipulates that under no circumstances, may the City and Board enter into any multi-year funding agreements that delay full funding of the retirement plan. The Charter requires that employer contributions be substantially equal to employee contributions (SDCERS' legal counsel has opined that this requirement applies to the normal cost contribution only). Pursuant to the Charter, City employer contribution rates, adjusted for payment at the beginning of the year, are actuarially determined rates and are expressed as a fixed annual required contribution as well as percentages of annual covered payroll. The entire expense of SDCERS' administration is charged against the earnings and plan assets of SDCERS.

The following table shows the City's contribution rates for fiscal year 2006, based on the valuation ending June 30, 2004, expressed as percentages of active payroll:

	Employer Contribution Rates	
	General Members	Safety Members
Normal Cost*	10.74%	19.21%
Amortization Payment*	10.39%	21.76%
Normal Cost Adjusted for Amortization Payment*	21.13%	40.97%
City Contribution Rates Adjusted for Payment at the Beginning of the Year	20.33%	39.42%

* *Rates assume that contributions are made uniformly during the Plan year.*

Normal Cost = The actuarial present value of pension plan benefits allocated to the current year by the actuarial cost method.

Amortization Payment = That portion of the pension plan contribution which is designed to pay interest on and to amortize the unfunded actuarial accrued liability.

Members are required to contribute a percentage of their annual salary to the Plan on a biweekly basis. Rates vary according to entry age. For fiscal year 2006, the City employee contribution rates as a percentage of annual covered payroll, averaged 10.57% for general members and 12.88% for safety members. A portion of the employee's share, depending on the employee's member class, is paid by the City. The amount paid by the City ranges from 4.61% to 7.61% of covered payroll for general members. Of this, 1.6% came from the retirement fund employee rate reserve, and the remainder of the pick up was paid by the City. The rate for safety plan members ranges from 7.47% to 7.71%. Of this, 2.7% came from the retirement fund employee rate reserve and the remainder of the pick up was paid by the City. On June 30, 2006, the employee rate reserve was depleted, after which employees began to pay for the difference. All future employee contributions paid by the City will be made from the City's operating budget. The amount paid on behalf of the employees has been renegotiated through the meet and confer process and reduced the amount of the employee contribution paid for by the City. In accordance with agreements with the labor unions, any and all savings realized by these agreements must be set aside and ultimately leveraged to reduce the pension system's UAAL.

Under SDMC Sections 24.1501 and 24.1502, an annual calculation is required to determine the Annual Realized Investment Earnings ("Realized Earnings") of SDCERS' pension assets. In accordance with these SDMC sections, an annual distribution of these Realized Earnings, in priority order, takes place. The Realized Earnings are distributed to various SDCERS system reserves, SDCERS budget, and contingent benefits. The order of distribution and a more detailed discussion of each distribution follows: First, realized earnings are used to credit interest, at a rate determined by the SDCERS Board, which is currently 8%, to the Employer and Employee Contribution Reserves (these reserves increase Plan assets to fund the Plan liabilities for defined benefits), and Deferred Retirement Option Plan ("DROP") member accounts as well as funding the SDCERS Annual Budget (DROP and Budget disbursements decrease Plan assets). If earnings still remain, they are distributed for supplemental or contingent payments or transfers to reserves. These items include in a priority order: 1) Annual Supplement Benefit Payment ("13th Check") paid to retirees generally equal to approximately $30 (whole dollars) times the number of years of employment and paid only when there are sufficient annual Realized Earnings. 2) Corbett Settlement Payment paid to retirees who terminated employment prior to July 1, 2000 (In spite of costs being included in the ARC for the Actuarial Valuation dated June 30, 2006), Corbett Settlement payments not paid in any one year accrue to the next year and remain an obligation of SDCERS until paid). 3) Crediting interest to the Reserve for Supplemental Cost of Living Adjustment ("COLA"). After the above noted distribution, any remaining Realized Earnings are transferred to the Employer Contribution Reserve which increases system assets. Beginning in fiscal year 2006 actuarial valuation, the liabilities related to the 13th Check and Corbett Settlement Payments are included in the calculation of actuarial liabilities and are reflected in the ARC.

Paying supplemental or contingent payments out of Realized Earnings decreases system assets. This has the effect of increasing the UAAL and thereby decreasing the funded ratio. Another related impact is on the net return on system assets which is negatively impacted when earnings are diverted from system assets. The City recognizes SDMC Section 24.1502's negative impact to the UAAL and funded ratio; however, in order to eliminate the use of surplus undistributed earnings as described above, changes to the municipal code are necessary. To date these changes have not been codified as the result of disagreements over the effect Municipal Code amendments proposed by the City Attorney will have on benefits and whether such amendments are compliant with previous legal settlements.

Beginning in fiscal year 2005 when the reserve fund for healthcare benefits was depleted, the City funded the remaining retiree health benefits expense for fiscal year 2005 and the expenses for fiscal years 2006 and 2007 by transferring from the general and non-general funds into the retiree healthcare trust fund (discussed further in Note 13).

In November 2004, voters changed the City Charter and the mix of Board members requiring that a majority of the Board be independent of the City. Also, the Charter now requires that a 15-year amortization period be used for the UAAL beginning in fiscal year 2009; however, the SDCERS Board, in conjunction with the actuary, is currently using a 20-year amortization period with no negative amortization and has taken the position that it is legally responsible for establishing the valuation parameters, including the amortization period. Given the size of the City's current Unfunded Actuarially Accrued Liability, a change to a 15-year amortization schedule could have a significant impact on future annually required contributions. In the fiscal year 2006 valuation, the use of a 15-year amortization assumption would have increased the ARC by approximately 21%.

e. **Annual Pension Cost and Net Pension Obligation**

Annual Pension Costs

The normal cost (i.e. the actuarial present value of pension plan benefits allocated to the current year) and the UAAL amortization cost (i.e. the portion of the pension plan payment designed to amortize the UAAL) were determined using the Projected Unit Credit (PUC) actuarial funding method. The following are the principal actuarial assumptions used for the 2004 valuation (additional assumptions were used regarding a variety of other factors):

(a) An 8.0% investment rate of return, net of administrative expenses.**
(b) Projected salary increases of at least 4.75% per year.**
(c) An assumed annual cost-of-living adjustment that is generally 2% per annum and compounded. In addition, there is a closed group of special safety officers whose annual adjustment is equal to inflation (4.25% per year).

**Both (a) and (b) included an inflation rate of 4.25%.

The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a five-year period. In fiscal year 2007, the SDCERS Board approved the decision to begin the implementation of the actuary's recommendation to adopt a different asset smoothing method by marking the actuarial value of assets to market value in the fiscal year 2006 actuarial valuation. The method used by the actuary in fiscal year 2005 was not a commonly used method. The expected asset value asset smoothing method will commence with the fiscal year 2007 valuation. The UAAL for funding purposes, pursuant to the Gleason Settlement, is being amortized over a fixed 30-year period for the fiscal years 2006, 2007, and 2008. As of June 30, 2004, the valuation year used to compute the fiscal year 2006 annually required contribution, there were 29 years remaining in the amortization period. For valuations effective June 30 2008, SDCERS' Board of Administration decided to use a 20-year amortization schedule. Beginning with the valuation dated June 30, 2007, the normal cost and UAAL amortization cost will be determined using the Entry Age Normal actuarial method, the result of which will cause the UAAL to increase by $252,200 in fiscal year 2009.

The following table shows the City's annual pension cost ("APC") and the percentage of APC contributed for the fiscal year ended June 30, 2006 and two preceding years (in thousands):

Fiscal Year Ended June 30		APC	Percentage Contributed		Net Pension Obligation
2004	$	138,488	49.83%	$	232,536
2005		179,743	67.92%		290,190
2006		175,879	154.28%		194,720

Net Pension Obligation

Net Pension Obligation (NPO) is the cumulative difference, since the effective date of GASB 27 (fiscal year 1998), between the annual pension cost and the employer's contributions to the Plan. This includes the pension liability at transition (beginning pension liability) and excludes short term differences and unpaid contributions that have been converted to pension-related debt. As of June 30, 2006, the City's NPO is approximately $194,700 and is reported in accordance with GASB 27. See table above.

The change to NPO is derived by first calculating the City's Annual Required Contribution ("ARC"). The ARC is calculated by actuarially determining the cost of pension benefits accrued during the year (normal cost) and adding to that the annual amount needed to amortize the UAAL (amortization cost) as reported by the actuary, in accordance with the amortization period and method selected. The ARC is then increased by interest accruing on any outstanding NPO (NPO Interest) and then reduced by the amortization of the UAAL that is related to the NPO (ARC Adjustment).

The following shows the calculation for NPO based on the actuarial information provided to the City (in thousands):

ARC [Fiscal Year 2006]	$	170,072
Contributions [Fiscal Year 2006]		(271,349)
Interest on NPO		23,228
ARC Adjustment		(17,421)
Change in NPO		(95,470)
NPO Beginning of Year [Fiscal Year 2005]		290,190
NPO End of Year [Fiscal Year 2006]	$	194,720

NPO Components related to Retiree Health

The City's annual contribution to SDCERS pension trust fund, for the fiscal years ended June 30, 2005, 2004, and 2003, included amounts that were contributed to the 401(h) Fund for healthcare benefits and are reported net of this contribution. Annual realized earnings, as determined by the SDMC Sections 24.1501 and 24.1502, in the pension trust fund were withdrawn and used to offset the portion of the City's contribution that went to healthcare benefits instead of being retained in the pension trust fund. This funding mechanism is a violation of the Internal Revenue Code (IRC) Section 401(a). SDCERS hired counsel to make a filing to the IRS to correct this operational failure and potential IRC violation. (See Contingencies Note 18 for additional disclosures). The amounts paid from the pension trust fund for healthcare benefits were approximately $7,900 in fiscal year 2005, $12,800 in fiscal year 2004, and $11,500 in fiscal year 2003. These payments have been removed from the City contribution amounts and resulted in an increase to the City's NPO. The cumulative impact to the City's NPO related to the diversion of assets to fund retiree health is approximately $77,100. The City's contribution related to retiree health for the fiscal year 2006 was placed in a Retiree Health Trust Fund which is paid from the City's operating funds. (See Other Post Employment Benefits Note 13 for further details.)

NPO Components related to Employee Offset Liabilities

In fiscal year 1998, the City set aside $37,800 in funds from the pension trust fund's undistributed earnings to fund the Employee Contribution Rate Reserve, and in accordance with SDMC §24.1502, annually added 8% interest earnings to this reserve. This employee contribution reserve was to pay for the City's share (pick up) of the employee's retirement contribution. The amount of NPO related to the employee offset as of June 30, 2006 is $34,900. This reserve was depleted in fiscal year 2006. As noted in the Funding Contracts: Union Agreements section above, the agreements with labor unions resulted in the reduction of City "pick-up" of the employee pension contribution, followed by employees paying for the contribution upon depletion of the reserve.

NPO Components related to Corbett Settlement and Subsequent Benefit Increases

The City is amortizing the unfunded liability incurred as a result of the benefit increases pursuant to the Corbett Settlement. The City interprets GASB 27 to require that the amortization methods used in calculating funding for the Plan to be consistent with the method used to calculate Plan expense. Thus, the previous amortization method of 40 years open for expensing plan costs was found to be incorrect. The impact on the NPO related to Corbett as of June 30, 2006 is approximately $27,600.

NPO Components related to the Under Funding of Plan Contributions

As a result of the MP-1 and MP-2 funding contracts, the City's contributions for fiscal years 1996-2003 were less than the annual required contribution as determined by the actuary. The impact on the NPO related to the under funding of plan contributions as of June 30, 2006 is approximately $55,120.

f. **Actions taken on behalf of the City to address Pension Liability and Net Pension Obligation**

As part of the agreements with the labor unions, several benefits were altered or eliminated for all employees hired on or after July 1, 2005, including the Deferred Retirement Option Plan (DROP), the 13th Check, the option to purchase years of service credits ("air-time"), and retiree healthcare benefits; however, the retirement formula generally remains 2.5% at 55 for general members and 3.0% at 50 for safety members. Also for employees hired on or after July 1, 2005, it was agreed to establish a trust vehicle for a defined contribution plan to fund and determine retiree medical benefits. As of the issuance of this report, the employer/employee contributions for such a plan have not been determined. The City has consolidated health care options to help manage the cost of health care for both current and retired employees, and as part of the agreements with the labor unions, the new definition of "health-eligible retiree" states that employees must have 10 years of service with the City to receive 100% of the retiree health benefit and five years of service to receive 50% of the retiree health benefit.

In June 2006, the amount from labor concessions that was committed to address the pension's unfunded liability was $17,500 (general fund and non-general fund). The City has contributed $115,300 through the securitization of future tobacco revenue, transfers of actual tobacco revenue receipts, and additional employee "pick up" savings. This contribution is the same as that discussed in the Funding Contracts: Union Agreements section discussed previously. The contribution has created a reduction in the NPO in fiscal year 2006. The City is also exploring other financing options as a means to eliminate its NPO and UAAL.

DEFINED CONTRIBUTION PLANS

a. **Supplemental Pension Savings Plan - City**

Pursuant to the City's withdrawal from the Federal Social Security System effective January 8, 1982, the City established the Supplemental Pension Savings Plan ("SPSP"). Pursuant to the Federal Government's mandate of a Social Security Medicare tax for all employees not covered by Social Security hired on or after April 1, 1986, the City established the Supplemental Pension Savings Plan-Medicare ("SPSP-M"). The SPSP and SPSP-M Plans were merged into a single plan ("SPSP") on November 12, 2004 for administrative simplification, without a change in benefits. Pursuant to the requirements of the Omnibus Budget Reconciliation Act of 1990 ("OBRA-90") requiring employee coverage under a retirement system in lieu of coverage under the Federal Insurance Contributions Act ("FICA") effective July 1, 1991, the City established the Supplemental Pension Savings Plan-Hourly ("SPSP-H"). These supplemental plans are defined contribution plans administered by Wachovia Corporation to provide pension benefits for eligible employees. There are no plan members who belong to an entity other than the City. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings, less investment losses. The City's general retirement members and lifeguard members of the City's safety retirement members participate in the plan. Eligible employees may participate from the date of employment.

The following table details plan participation as of June 30, 2006:

Plan	Participants
SPSP	8,672
SPSP – H	4,173

The SPSP Plan requires that both the employee and the City contribute an amount equal to 3% of the employee's total salary each pay period. Participants in the Plan hired before July 1, 1986 may voluntarily contribute up to an additional 4.5% and participants hired on or after July 1, 1986 may voluntarily contribute up to an additional 3.05% of total salary, with the City matching each. Hourly employees contribute 3.75% on a mandatory basis which is also matched by City contributions.

Under the SPSP Plan, the City's contributions for each employee (and interest allocated to the employee's account) are fully vested after five years of continuous service at a rate of 20% for each year of service. Hourly employees are immediately 100% vested. The unvested portion of City contributions and interest forfeited by employees who leave employment before five years of service are used to reduce the City's cost.

In fiscal year 2006, the City and the covered employees contributed approximately $24,622 and $25,528, respectively. As of June 30, 2006, the fair value of plan assets totaled approximately $478,984. SPSP is considered part of the City of San Diego's financial reporting entity and is reported as a pension and employee savings trust fund.

b. **401(k) Plan - City**

The City established a 401(k) Plan effective July 1, 1985. The 401(k) Plan is a defined contribution plan administered by Wachovia Corporation to provide pension benefits for eligible employees. Employees are eligible to participate from date of employment. Employees make contributions to their 401(k) Plan accounts through payroll deductions, and may also elect to contribute to their 401(k) account through the City's Employees' Flexible Benefits Program.

The employees' 401(k) contributions are based on IRS calendar year limits. Employees contributed approximately $26,870 during the fiscal year ended June 30, 2006. There is no City contribution towards the 401(k) Plan.

As of June 30, 2006, the fair value of plan assets totaled approximately $196,385. The 401(k) Plan is considered part of the City's financial reporting entity and is reported as a pension and employee savings trust fund.

c. **Pension Plan - Centre City Development Corporation (CCDC)**

CCDC has a Money Purchase Pension Plan covering all full-time permanent employees (the "CCDC Plan"). The CCDC Plan is a defined contribution plan under which benefits depend solely on amounts contributed to the plan plus investment earnings. Employees are eligible to participate on the first day of the month following 90 days after their date of employment. During each year, CCDC contributes semi-monthly an amount equal to 8% of the total quarterly compensation for all employees. CCDC's contributions for each employee are fully vested after six years of continuous service. CCDC's total payroll in fiscal year 2006 was approximately $3,647. CCDC contributions were calculated using the base salary amount of approximately $3,262. CCDC made the required 8% contribution amounting to approximately $261 (net of forfeitures) for fiscal year 2006.

In addition, CCDC has a Tax Deferred Annuity Plan covering current and previous eligible employees. The CCDC Plan is a defined contribution plan under which benefits depend solely on amounts contributed to the plan by the employer and the employees, plus investment earnings. Employees are eligible to participate on the first day of the month following 90 days after their date of employment. During each plan year, CCDC contributes semi-monthly an amount equal to 16% of the total semi-monthly compensation for eligible employees. This amount includes a 3% increase from the prior year as approved by the Board of Directors on August 13, 2003. CCDC's contributions for each employee are fully vested at time of contribution. The Tax Deferred Annuity Plan includes amounts deposited by employees prior to CCDC becoming a contributor to the CCDC Plan. CCDC made the required 16% contribution amounting to approximately $516 for fiscal year 2006.

The fiduciary responsibilities of CCDC consist of making contributions and remitting deposits collected. The City does not hold these assets in a trustee or agency capacity for CCDC; therefore, these assets are not reported within the City's basic financial statements.

d. **Pension Plan - San Diego Convention Center Corporation (SDCCC)**

SDCCC's Money Purchase Pension Plan (the "SDCCC Plan") became effective January 1, 1986. The SDCCC Plan is a qualified defined contribution plan and as such, benefits depend on amounts contributed to the SDCCC Plan plus investment earnings less allowable plan expenses. The SDCCC Plan covers employees not otherwise entitled to a retirement/pension plan provided through a collective bargaining unit agreement. Employees are eligible at the earlier of the date on which they complete six months of continuous full-time service, or the twelve-month period beginning on the hire date (or any subsequent Plan year) during which they complete 1,000 hours of service.

A plan year is defined as a calendar year. SDCCC's balance for each eligible employee is vested gradually over five years of continuing service with an eligible employee becoming fully vested after five years. Forfeitures and SDCCC Plan expenses are allocated in accordance with Plan provisions. A trustee bank holds the SDCCC Plan assets. The City does not act in a trustee or agency capacity for the SDCCC plan; therefore, these assets are not reported within the City's basic financial statements.

For the year ended June 30, 2006, pension expenditures for the SDCCC Plan amounted to $1,223. SDCCC records pension expenditures during the fiscal year based upon estimated covered compensation.

e. **Pension Plan - San Diego Data Processing Corporation (SDDPC)**

SDDPC has accrued and set aside funds in a money market account to provide employees who transferred from the City to SDDPC with retirement benefits approximately equal to those under the City's retirement plan. As of June 30, 2006, the balance in the account was $133.

The balance at June 30, 2006 consisted of the total estimated liability plus interest earned on the account since its establishment in fiscal year 1991.

In addition, SDDPC has in effect a Money Purchase Pension Plan (the "SDDPC Plan") covering substantially all employees. The SDDPC Plan is a defined contribution plan, wherein benefits depend solely on amounts contributed to the plan plus investment earnings. Employees are eligible to participate from the date of employment. During each plan year, SDDPC contributes monthly an amount equal to 20% of the total monthly compensation for all employees. SDDPC contributions for each employee are fully vested after four years of continuing service. The City does not act in a trustee or agency capacity for the SDDPC Plan; therefore, these assets are not reported within the City's basic financial statements. SDDPC's total payroll in fiscal year 2006 was approximately $17,686. As all employees are substantially covered, SDDPC contributions were calculated using this base salary amount. SDDPC made the required 20% contribution, amounting to approximately $3,527.

f. **Pension Plan - San Diego Housing Commission (SDHC)**

SDHC provides pension benefits for all its full-time employees through a defined contribution plan (the "SDHC Plan"). In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. Employees are eligible to participate on the first day of their employment. SDHC's contributions for each employee (and interest allocated to the employee's account) are fully vested after four years of continuous service. SDHC's contributions for, and interest forfeited by, employees who leave employment before four years of service are used to reduce the SDHC's current-period contribution requirement. SDHC's covered payroll in fiscal year 2006 was approximately $11,062. SDHC made the required 14% contribution, amounting to approximately $1,549 for fiscal year 2006. The City does not act in a trustee or agency capacity for the SDHC Plan; therefore, these assets are not reported within the City's basic financial statements.

g. **Pension Plan - Southeastern Development Corporation (SEDC)**

SEDC has an optional Simplified Employee Pension Plan covering all full-time permanent employees (the "SEDC Plan"). The SEDC Plan is a defined contribution plan administered by Morgan Stanley Dean Witter. Under section 212 of the SEDC Employee Handbook, employees are eligible to participate six months after their date of employment, and SEDC contributes a monthly amount equal to 12% of the employees' base salary, or 15% of management employees' base salary. Such contributions are fully vested upon contribution. SEDC's total payroll in fiscal year 2006 was approximately $1,034. SEDC contributions were calculated using the base salary amount of approximately $945. SEDC made the required contribution, amounting to approximately $126 for fiscal year 2006. SEDC Plan members contributed an additional $7.5.

13. OTHER POST EMPLOYMENT BENEFITS (In Thousands)

a. Plan Description

The City provides certain healthcare benefits to a variety of retired employees through SDCERS, as provided for in San Diego Municipal Code (SDMC) SDMC Sections 24.1201 through 24.1204. Currently, the benefits are primarily for health-eligible retirees who were actively employed on or after October 5, 1980 and were otherwise entitled to retirement allowances. Health eligible retirees can obtain health insurance coverage with the plan of their choice, including any City-sponsored, union-sponsored, or privately-secured health plan. In fiscal year 2006, health eligible retirees who are also eligible for Medicare are entitled to receive reimbursement/payment of healthcare premiums, limited to approximately $6.8 per year, in addition to reimbursement/payment for Medicare Part B premiums, limited to approximately $1.0 per year. Health eligible retirees who are not eligible for Medicare are entitled to receive reimbursement/payment of healthcare premiums, limited to approximately $7.2 per year. Non-health-eligible employees who retired or terminated prior to October 6, 1980 or employees who were hired after July 1, 2005, and who are otherwise eligible for retirement allowances, are also eligible for reimbursement/payment of healthcare benefits, limited to a total of $1.2 per year.

b. Contributions

Expenses for post-employment healthcare benefits were paid for on a pay-as-you-go basis through fiscal year 2007. In fiscal year 2006, approximately 4,100 retirees received either City paid insurance or were reimbursed for other health insurance costs incurred amounting to approximately $24,100. Approximately $17,400 was paid by the City and approximately $6,400 was paid by retirees for beneficiary health benefits. Remaining retiree healthcare expenditures of approximately $300 were accrued by the City and paid for in fiscal year 2007. These contributions were placed into a trust fund called the Retiree Health Trust Fund, and all retiree healthcare expenses are paid directly from this fund by SDCERS. The City is currently implementing a plan to ensure that sufficient resources are available in the Retiree Health Trust Fund to pay for retiree healthcare expenses in future periods.

In July 2004, GASB issued GASB 45, *Accounting and Financial Reporting by Employers for Post Employment Benefits Other Than Pensions* (OPEB), which establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial statements. The City will implement GASB 45 in the financial statements for the fiscal year ending June 30, 2008. In preparation to meet the requirements of GASB 45, the City entered into an agreement on January 18, 2008 to pre-fund expenses related to post-employment healthcare benefits. The plan, administered by CalPERS, requires the City to pre-fund the plan in an amount not less than $5,000; however, the City intends to pay an amount not less than 50% of the Annual Required Contribution, as calculated by an actuary of the City's choice. Post-employment healthcare actuarial accrued liability and any unfunded actuarial accrued liability will be reported in the required supplemental information in a manner similar to pension obligations.

14. INTERFUND RECEIVABLES, PAYABLES, AND TRANSFERS (In Thousands)

Interfund Working Capital Advance (WCA) balances are the result of loans between funds that are expected to be repaid in excess of one year. The majority of the advances, $4,114, are advances from the HUD Section 108 and NTC Section 108 grant funds to the Redevelopment Agency. Interfund WCA balances at June 30, 2006 are as follows:

	Benefiting Fund (Payable)		
Contributing Fund (Receivable)	General Fund	NonMajor Governmental	Total
General Fund	$ -	$ 300	$ 300
NonMajor Governmental	-	4,414	4,414
Sewer Utility	341	-	341
Water Utility	644	-	644
Total	$ 985	$ 4,714	$ 5,699

Interfund receivable and payable balances are the result of loans between funds that are expected to be repaid during the next fiscal year. The majority of these short-term loans, approximately $21,000, represents General Fund, TOT fund, and Transnet fund loans to expenditure-driven grant funds that have temporary cash shortfalls, pending reimbursement from the Federal Government and the State. Interfund receivable/payable balances at June 30, 2006 are as follows:

	Benefitting Fund (Payable)
Contributing Fund (Receivable)	Nonmajor Governmental
General Fund	$ 6,060
Nonmajor Governmental	15,364
Nonmajor Enterprise	3,399
Total	$ 24,823

The Water Utility Fund has an interfund loan receivable of $2,386 and interfund interest receivable of $773, and the Capital Outlay Fund has a corresponding interfund loan payable of $2,386 and interfund interest payable of $773, for a loan agreement in which the Water Utility financed a land acquisition for the government. This land held for resale in the Capital Outlay Fund was sold to the Redevelopment Agency on October 16, 2006. The purchase price of the land was $6,380, of which $3,191 (which includes accrued interest) will be repaid to the Water Utility Fund and the remainder will be placed in the Capital Outlay Fund.

The Sewer Utility Fund has an interfund loan receivable of $3,487, and the Black Mountain Ranch Facilities Benefit Assessment Fund, a capital projects fund, has a corresponding interfund payable of $3,487 for advanced Facilities Benefit Assessment (FBA) project funding. The Sewer Fund agreed to finance the Carmel Valley Trunk Sewer project to facilitate earlier construction, of which a portion was deemed the responsibility of the Carmel Valley area developers and is intended to be reimbursed in fiscal year 2010 from FBA Fund assessment revenue.

Interfund transfers result from the transfer of assets without the expectation of repayment. Transfers are most commonly used to (1) move revenues from the fund in which it is legally required to collect them into the fund which is legally required to expend them, including Transient Occupancy Tax (TOT), Storm Drain, and TransNet funds collected in said funds but legally spent within the General Fund, (2) utilize unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds, in accordance with budgetary authorizations, and (3) move tax revenues collected in the special revenue funds to capital projects and debt service funds to pay for the capital projects and debt service needs during the fiscal year. Interfund transfer balances at June 30, 2006 are as follows:

	Benefiting Fund							
Contributing Fund	General Fund	NonMajor Governmental	Sewer Utility	Water Utility	NonMajor Enterprise	Internal Service	Capital Asset Transfers	Total
General Fund	$ -	$ 21,946	$ -	$ -	$ -	$ 246	$ -	$ 22,192
NonMajor Governmental	71,672	318,507	-	-	962	576	-	391,717
Sewer Utility	-	1,692	-	-	-	147	266	2,105
Water Utility	-	999	-	-	-	158	482	1,639
NonMajor Enterprise	1,685	558	-	-	-	101	10	2,354
Internal Service	1,304	737	481	220	224	244	-	3,210
Total	$ 74,661	$ 344,439	$ 481	$ 220	$ 1,186	$ 1,472	$ 758	$ 423,217

15. RISK MANAGEMENT (In Thousands)

The City is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The City has established various self-insurance programs and maintains contracts with various insurance companies to manage excessive risks.

The City participates in an excess liability insurance policy in collaboration with a statewide joint powers authority risk pool, the California State Association of Counties-Excess Insurance Authority (CSAC-EIA) whereby the City pays the first $1,000 per occurrence. Effective July 2003, the City's excess liability insurance coverage was obtained through a sister joint powers risk pool, California Public Entity Insurance Authority (CPEIA) for amounts up to $50,000 per occurrence in excess of a $2,000 self-insured retention. On October 1, 2007, the City's self-insurance retention *amount increased to $5,000.*

The City offers a cafeteria-style flexible benefits plan. This plan requires employees to choose a health and life insurance plan and also gives employees the option of obtaining dental insurance, vision insurance, or catastrophic care insurance. Employees can place remaining flexible benefit dollars into IRS qualified dental/medical/vision and childcare reimbursement accounts, into their 401(k), and/or take as cash.

The City is self-insured for workers' compensation and long-term disability (LTD). All operating funds of the City participate in both these programs and make payments to the Self Insurance Fund. Each fund contributes an amount equal to a specified rate multiplied by the gross salaries of the fund. These payments are treated as operating expenditures in the contributing funds and operating revenues in the Self Insurance Fund.

Public liability, workers' compensation, and long-term disability estimated liabilities as of June 30, 2006 are determined based on results of independent actuarial evaluations and include amounts for claims incurred but not reported and adjustment expenses. Claims liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amount of payouts, and other economic and social factors. Estimated liabilities for public liability claims have been recorded in the Self Insurance Fund, Sewer Utility Fund, and Water Utility Fund.

A reconciliation of total liability claims, for all three funds, showing current and prior year activity is presented below:

	Public Liability	Workers' Comp & Long-Term Disability	Total
Balance, July 1, 2004	$ 101,861	$ 150,302	$ 252,163
Claims and Changes in Estimates	24,996	40,037	65,033
Claim Payments	(24,508)	(26,933)	(51,441)
Balance, June 30, 2005	102,349	163,406	265,755
Claims and Changes in Estimates	11,623	28,832	40,455
Claim Payments	(28,563)	(24,786)	(53,349)
Balance, June 30, 2006	$ 85,409	$ 167,452	$ 252,861

The City also participates in the joint purchase of its first party property insurance including all-risk, flood, boiler and *machinery and business interruption coverages through the CSAC-EIA pool.* Earthquake coverage is purchased separately through the pool. The joint purchase of the City's "all risk" property insurance, insuring approximately $2,000,000 in value of City property and assets, provides coverage for losses to City property up to approximately $400 per occurrence, subject to a $25 deductible. This limit includes coverage for business interruption losses for designated lease-financed locations. There is no sharing of limits among the City and member counties of the CSAC-

EIA pool, unless the City and member counties are mutually subject to the same loss. Limits and coverages may be adjusted periodically in response to requirements of bond financed projects, acquisitions, and in response to changes in the insurance marketplace.

Earthquake coverage is provided for designated buildings/structures and certain designated City lease financed locations in the amount of $60,000 including coverage for business interruption caused by earthquake at certain designated locations. Earthquake coverage is subject to a deductible of 5% of total values per unit per occurrence, subject to a $100 minimum. The City's earthquake coverage is purchased jointly and shared with the member counties in the CSAC-EIA pool. Due to the potential for geographically concentrated earthquake losses, the CSAC-EIA pool is geographically diverse to minimize any potential sharing of coverage in the case of an individual earthquake occurrence. Depending upon the availability and affordability of such earthquake insurance, the City may elect not to purchase such coverage in the future, or the City may elect to increase the deductible or reduce the coverage from present levels.

The City is a public agency subject to liability for the dishonest acts and negligent acts or omissions of its officers and employees acting within the scope of their duty ("employee dishonesty" and "faithful performance"). The City participates in the joint purchase of insurance covering employee dishonesty and faithful performance through the CSAC-EIA pool. Coverage is provided in the amount of $10,000 per occurrence subject to a $25 deductible.

During the year reported hereon, there were no significant reductions in insurance coverage from the prior year. For each of the past three fiscal years, the settlements have not exceeded insurance coverage.

See Contingencies, Note 18, for additional information.

16. FUND BALANCE / NET ASSETS DEFICIT (In Thousands)

The Grants Fund and the Capital Outlay Fund have net deficits of approximately ($30,082) and ($18,453), respectively, due to the large number of reimbursement grants accounted for within these funds. With reimbursement grants, the resources remain the property of the grantor until allowable costs are incurred. The grants revenues are recognized as soon as all eligibility criteria have been met and the amounts become available. This results in a deficit fund balance in these funds.

The Self Insurance Fund has a net deficit of approximately ($168,494), which represents unfunded estimated claims and claim settlements related to Public Liability, Workers' Compensation, and Long-Term Disability. It is anticipated that individual claim settlements will be funded through future user charges subsequent to the filing of a claim and prior to its settlement. In addition to user charges, in January 2008, the Mayor's office presented a five-year financial outlook to the City Council that outlines a proposal to fund the Self Insurance Fund by contributing an additional $5,000 to the Public Liability Reserves in fiscal year 2008.

Publishing Services has a net deficit of ($249), due to a decline in work production, and outdated pricing for services which are not fully cost recoverable.

The Retiree Health Trust Fund has a net deficit of approximately ($280), due to an accrual of administrative expenses paid in fiscal year 2007. The City is currently implementing a plan to ensure that sufficient resources are available in the Retiree Health Trust Fund to pay for retiree healthcare expenses in future periods.

17. COMMITMENTS (In Thousands)

As of June 30, 2006, the City's business-type activities contractual commitments are as follows:

Airports	$	803
Environmental Services		2,935
Sewer Utility		57,417
Water Utility		47,716
Other		3,623
Total Contractual Commitments	$	112,494

The contractual commitments are to be financed with existing reserves and future service charges. In addition, the Sewer and Water Utility Funds intend to finance the contractual commitments with existing reserves, future service charges, and financing proceeds secured by system revenues.

Consent Decree

On April 2, 2001, two environmental groups filed suit against the City alleging that the Municipal System's collection system was deficient as a result of sewer spills from December 1996 to the time of the filing. The complaint sought injunctive relief to prevent illegal discharges, a compliance schedule to upgrade the Municipal System's collection system, and civil penalties of $27.5 per day for each day of a violation. The City contested the plaintiffs' claims.

The Environmental Protection Agency (EPA) and the State also filed suits against the City alleging the same collection system violations, seeking unspecified penalties and injunctive relief for collection system improvements. All three cases were consolidated. On March 16, 2005, the City settled the State lawsuit for $1,200. Of this total, $1,000 funded three supplemental environmental projects to benefit the local environment, and $200 was deposited in the State's Cleanup and Abatement Account.

The EPA, the City and the environmental groups reached an agreement on additional requirements to reduce sewer spills, which are set forth in a Consent Decree (the "Consent Decree"). The Consent Decree requires increased sewer spill response and tracking, increased root control, replacement or rehabilitation of 250 miles of pipeline, a canyon economic and environmental analysis, pump station and force main upgrades, and entails court supervision of these upgrades at least through June 2013. The estimated annual cost of this commitment is $108,000 per year in capital projects and $47,000 per year in operational maintenance to the sewer system through the term of the settlement; however, the costs for bidding, constructing and completing the required work will fluctuate depending on variables such as changes in the cost of materials and labor. No civil penalty payment was required, though stipulated penalties ranging from $375 (in whole dollars) to $20,000 (in whole dollars) per occurrence are included for subsequent violations of the Consent Decree. The Consent Decree was approved by the Court on October 9, 2007, settling all remaining issues in the case.

Sewer rate increases were approved for the next four years to partially fund the obligations of the Consent Decree. However, additional rate increases will be necessary (likely beginning in year 2011) to completely fund the Consent Decree. As mentioned previously, the estimated annual cost is $108,000/year in capital projects and $47,000/year in operations and maintenance. The City funds the Capital Projects in the Consent Decree through the issuance of notes and bonds supported by the sewer system's net system revenues.

California Department of Public Health Compliance Order

In 1994, the City of San Diego entered into a compliance agreement with the State of California Department of Public Health ("DPH") with the approval of City Council, after the DPH Drinking Water Field Operations Branch conducted a sanitary survey of the City's water system. This agreement required the City to correct operational deficiencies and begin necessary capital improvements. The City was notified in January of 1997 that it was not in compliance with this agreement. At that time, the DPH issued a compliance order. The January 1997 Compliance Order was last amended in May of 2007 ("Amendment 11"), and included additional items that were not in the original Compliance Order. The DPH Compliance Order will remain in effect until the required projects are completed.

Presently, the Water Department is meeting all of the requirements of the DPH Compliance Order, including the ongoing obligation to provide DPH with quarterly progress reports. On February 26, 2007, the City authorized an increase in water rates and charges to continue funding projects mandated in the DPH Compliance Order as well as other Capital Improvement Program projects. In addition, on October 8, 2007, the City authorized a second "pass-thru" rate increase to account for the higher cost of water purchased from the San Diego County Water Authority. The pass-thru rate increase took effect on January 1, 2008 and will help preserve the funds previously committed to DPH Compliance Order projects.

DPH has the authority to impose civil penalties if the City fails to meet DPH Compliance Order deadlines, although DPH has not imposed such penalties to date. Violation of the DPH Compliance Order may be subject to judicial action, including civil penalties specified in California Health and Safety Code, Section 116725. Section 116725 penalties for violating a schedule of compliance for a primary drinking water standard can go as high as $25 per day for each violation; for violating other standards, such as turbidity, the penalties can reach $5 per day. There are a number of additional enforcement tools prescribed by law, including mandatory water conservation, litigation and service connection moratoriums.

The costs for bidding, constructing and completing the required work will fluctuate depending on variables such as changes in the cost of materials and labor. As of 2007, the Water Department's DPH Compliance Order project and DPH related project costs approximate:

Total Projects	FY07	FY08 - FY11	FY12 - FY19	TOTAL
DPH & EPA Requirements	$ 28,292	$ 345,747	$ 214,877	$ 588,916
DPH Related Projects	4,614	137,191	315,245	457,050

These commitments are to be financed with existing net assets, present and future revenues, and financing proceeds secured by system revenues.

Convention Center Dewatering

The City operates the San Diego Convention Center, located adjacent to San Diego Bay. The Convention Center includes a subterranean parking garage, which is subject to infiltration of water from the bay. This groundwater must be continually pumped from the parking structure to prevent it from being submerged. Approximately 500,000 gallons of groundwater is pumped daily from the parking structure and discharged into San Diego Bay. The City holds a National Pollutant Discharge Elimination System ("NPDES") permit for the discharge, issued by the Regional Water Quality Control Board ("RWQCB"). Failure to meet water quality standards set forth in the permit could subject the City to fines and penalties of up to $25,000 (in whole dollars) per day.

Monthly groundwater discharge sample results have not met the standards dictated by NPDES Permit No. CA0109029 (Order R9-2003-0050) since the end of calendar year 2005. This triggered the implementation of work to cease effluent violations within twenty seven months (end of March 2008), pursuant to an order of the RWQCB.

To achieve compliance with groundwater discharge requirements, the City retained an engineering consultant in 2006 to review all previous work and develop the most cost-effective engineering solution to achieve compliance. The consultant's final report was received in August 2007. A determination will be made as to which report recommendations will be implemented. Possible solutions include constructing facilities to treat the groundwater before it is discharged into the bay, or diverting the groundwater into the sewer system for treatment at an existing plant. Costs for implementing the report's recommended potential solutions could range from a one-time expense of between \$5,600 to \$9,500, and annual operation and maintenance expenses of \$528 to \$793 per year. Funding to implement any of the potential solutions is the responsibility of the City General Fund, though the San Diego Port District, which owns the Convention Center property, may also be partially responsible.

The City of San Diego plans to take necessary actions to achieve groundwater discharge NPDES compliance by the end of March 2008. Upon completion by the City of an action plan to address the groundwater discharge problem and the identification of required funding, the City plans to communicate with the Regional Water Quality Control Board ("RWQCB") on the final details of the plan. If compliance is not achieved by March 2008, the Board could enact enforcement actions against the City of San Diego.

18. CONTINGENCIES (In Thousands)

FEDERAL AND STATE GRANTS

The City recognizes revenue grant monies received as reimbursement for costs incurred in certain Federal and State programs it administers. Although the County's Federal grant programs are audited in accordance with the requirements of the Federal Single Audit Act of 1984, the Single Audit Act Amendments of 1996 and the related U.S. Office of Management and Budget Circular A-133, these programs may be subject to financial and compliance audits by the reimbursing agencies. The amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time. The Single Audit for fiscal year 2004 was completed by Macias Gini & O'Connell LLP and has been received and filed by the City Council. Macias Gini & O'Connell LLP also completed the Single Audit for fiscal year 2005; however, this report has not yet been received and filed by the City Council. Additionally, Macias Gini & O'Connell LLP is still in the process of completing the Single Audit for fiscal year 2006.

Additionally, the local unit of the U.S. Department of Housing and Urban Development (HUD) has recently conducted an audit of the City's Community Development Block Grant (CDBG) program. The overall objective of the audit was to determine whether management complied with applicable laws, regulations, and requirements of HUD's CDBG program. After review of the program, HUD determined that the City may not be in compliance with CFR 85.25. Specifically, HUD is concerned with CDBG loans to the Redevelopment Agency, "Re-Loans", and other program eligibility issues. The Office of the Inspector General is currently conducting a preliminary review to determine if an additional audit is required.

CONTINUING DISCLOSURE OBLIGATIONS

The City, in connection with all bond offerings since the effective date (July 1995) of the continuing disclosure requirements of SEC Rule 15c2-12, has contractually obligated itself to provide annual financial information, including audited financial statements, within certain specified time periods (generally nine months) after the end of each fiscal year. The City completed, and Council has received and filed, its financial statements for fiscal year ended June 30, 2004 and June 30, 2005. The City has not yet released its audited financial statements for the fiscal year ended June 30, 2007. Accordingly, the City has not been able to timely satisfy its contractual obligations to provide to the national repositories audited financial statements, or financial information and operating data derived from the financial statements. At the time of each deadline, the City did, as required by its continuing disclosure contractual obligations, provide to the national repositories a notice of the failure to file the audited annual financial statements information.

REGULATORY AND OTHER INDEPENDENT INVESTIGATIONS

In November 2006, the Securities and Exchange Commission (SEC) entered an Order sanctioning the City of San Diego for committing securities fraud by failing to disclose, in 2002 and 2003, important information about its pension and retiree health care obligations in connection with disclosures relating to the sale of its municipal bonds. To settle the action, the City agreed to cease and desist from future securities fraud violations and to retain an independent consultant for three years to foster compliance with its disclosure obligations under the federal securities laws.

In issuing the Order, the SEC made the following determinations:

- The City failed to disclose that the City's unfunded liability to its pension plan was projected to increase to an estimated $2 billion at the beginning of fiscal year 2009, and that the City knew and failed to disclose that its health care liability would be in excess of $1.1 billion. (The information presented in the SDCERS actuarial valuation for the fiscal year ended June 30, 2007, which will be incorporated in the City's fiscal year 2009 financial statements, reported the unfunded actuarial liability to be $1.183 billion.)

- The City failed to disclose that it had been intentionally under-funding its pension obligations so that it could increase pension benefits but defer the costs, and that it would face severe difficulty funding its future pension and retiree healthcare obligations unless new revenues were obtained, pension and healthcare benefits were reduced, or City services were reduced.

- The City knew or was reckless in not knowing that its disclosures were materially misleading.

- The Order finds that the City made these misleading statements through three different means:

  1. In the offering documents for five municipal offerings in 2002 and 2003 that raised over $260 million from investors. The offering documents containing the misleading statements included the "official statements," which were intended to disclose material information to investors, and the "preliminary official statements," which were used to gauge investors' interest in a bond issuance.

  2. The City made misleading statements to the agencies that gave the City its credit rating for its municipal bonds.

  3. The City made misleading statements in its "continuing disclosure statements," which described the City's financial condition and were provided by the City to the municipal securities market with respect to prior City bond offerings.

The City consented to the issuance of the Order without admitting or denying the findings in the Order. The SEC's investigation with respect to the misleading disclosures in the City's fiscal year 2002 and fiscal year 2003 financial statements is ongoing as to individuals and other entities that may have violated the federal securities laws.

The SEC Order sanctioning the City of San Diego for committing securities fraud is available at: www.sec.gov

Prior to settlement with the SEC, the City engaged a number of firms to review the City's disclosure practices and to investigate potential illegal acts. In February 2004, the law firm of Vinson & Elkins LLP (V&E) was engaged to conduct a review of the adequacy of the City's financial disclosure relating to the pension fund in bond offerings from 1996 to 2002 and to prepare a report on its findings. In September 2004, V&E released a report that identified a number of disclosure deficiencies and made recommendations on how to remediate their causes. The report did not offer conclusions on the culpability of individual members of the City's government.

Many of the recommendations contained in the V&E report were adopted by the City in October 2004. However, the City's previous accounting firm advised that the report did not provide a sufficient basis to conclude that all questions necessary to the completion of the audit were sufficiently investigated and resolved in a manner that would permit the issuance of an audit report. In response, the City engaged a professional consulting firm, Kroll Inc. and the law firm Willkie, Farr and Gallagher LLP, to act in the capacity of an audit committee. Kroll took over the investigation. The independent investigations concluded when Kroll presented its final report to the City on August 8, 2006. The Kroll report concluded that there were numerous failures on the part of City government to conform to law, to adhere to principles of sound governance and financial reporting, and to protect the financial integrity of the City's pension system. The Kroll report was more fully summarized in the City's fiscal year 2003 financial report. The City's fiscal year 2003 financial report, and the entire Kroll report including interview summaries and footnotes, as well as the V&E report, are available at: www.sandiego.gov.

REMEDIATION OF CITY DISCLOSURE DEFICIENCIES

The City has taken a variety of remedial actions in the wake of the disclosure deficiencies identified by V&E, Kroll and the SEC. In response to the V&E Report, the City amended the municipal code to address certain control environment issues.

The Disclosure Ordinance created a Disclosure Practices Working Group of City officials to review the form and content of all financial disclosures by the City and its related entities and a finance and disclosure unit within the City Attorney's office headed by an attorney with experience in municipal securities and disclosure matters. Pursuant to the Ordinance, the Auditor and Comptroller is required to annually review and report on internal controls within the City. In addition, mandatory training is required for City staff and officials, including the City Council and Mayor, regarding their obligations under federal and state securities laws.

Further reforms were proposed by the Mayor to address deficiencies identified in the Kroll Report. A monitor, who also serves as the Independent Consultant pursuant to the Order, was appointed on January 26, 2007, to oversee the implementation of the Mayor's remediation plan. Structural changes were made to the City's Finance Department to enhance accountability to the City's Chief Financial Officer, who also serves as the Auditor and Comptroller. The City Council amended the Municipal Code to create an Audit Committee comprised of three Councilmembers, which provides legislative oversight of the City's accounting and financial reporting processes and internal audit function.

In Fall 2007, an Internal Auditor was appointed by the Mayor, in consultation with the Audit Committee. The Internal Auditor reports to both the Chief Operating Officer and the Audit Committee. The City has also retained an independent actuary to provide periodic analysis of SDCERS' actuarial reporting and of the fiscal impact of pension and benefit related decisions. An Enterprise Resource Planning ("ERP") system has been purchased to enhance the timeliness and accuracy of the City's operational reporting; the first ERP modules are scheduled for activation in October 2008.

Certain recommendations included in the Kroll Report and the Mayor's remediation plan require further action by the City or the voters. An ordinance imposing criminal penalties for City employees who improperly influence the City's outside consultants has not been presented to the City Council for consideration. Changes to the City Charter to enhance the independence of both the Internal Auditor and the Audit Committee require voter approval and proposed Charter amendments have been approved for inclusion on the ballot for the June 3, 2008 election.

The Independent Consultant required by the SEC Order has several specific mandates. Among these are annual reviews, for a three year period, of the City's policies, procedures and internal controls regarding financial disclosures. The Independent Consultant is also required to make recommendations concerning the City's policies, procedures and internal controls and to assess the City's adoption and implementation of these recommendations. A draft of the Independent Consultant's first annual report was presented to management in March 2008. The final version is expected to be presented to the City Council in April 2008.

GENERAL INVESTIGATIONS

The City Attorney is currently being investigated by the California State Bar. Bar investigations are confidential and the scope, nature, and likely outcome of the investigation are not known.

LITIGATION AND REGULATORY ACTIONS

The City is a defendant in lawsuits pertaining to material matters, including claims asserted which are incidental to performing routine governmental and other functions. This litigation includes but is not limited to: actions commenced and claims asserted against the City arising out of alleged torts; alleged breaches of contracts; alleged violations of law; and condemnation proceedings. The City has received approximately 2,400 notices of claims in fiscal year 2006.

The estimate of the liability for unsettled claims has been reported in the Government-Wide Statement of Net Assets, the Proprietary Fund Statement of Net Assets, and in the Proprietary Fund financial statements. The liability was estimated by categorizing the various claims and supplemented by information provided by the City Attorney with respect to certain large individual claims and proceedings. The recorded liability is the City's best estimate based on available information.

Significant individual lawsuits are described below.

De La Fuente Business Park v. City of San Diego

This lawsuit, filed in 1995, involves allegations of breach of contract and inverse condemnation brought by an Otay Mesa developer. In the first proceeding, the jury returned a verdict of $94,500 in favor of the plaintiff. On appeal, the court issued a tentative ruling that the case will be remanded to trial again on the contract issue, and that the inverse condemnation was not valid as a matter of law. There are also two other pending cases similar in nature that have been filed by the same Otay Mesa developer. These cases are on hold in the trial court, pending the outcome of the Business Park case. According to the City Attorney, the possible exposure of these cases ranges between $0 and $60,000. Liabilities for these cases were not accrued in the City's financial statements as the City Attorney has indicated the likelihood that the plaintiff will prevail is only *reasonably possible.*

Abbit, Ernest v. City of San Diego

Plaintiffs are 298 individuals from the De Anza Mobilehome Park that are alleging Mobilehome Residency Law "MRL" violations by the City of San Diego. The likelihood of an unfavorable outcome is reasonably possible and is estimated to be in the range of $0 - $22,000.

Wood, Janet v. City of San Diego

Plaintiff sued as a representative class claiming that women and unmarried retirees receive less pension benefits than others. Case has been remanded to the district court in September 2007. Likelihood of unfavorable outcome is reasonably possible and is estimated to be in the range of $0 - $2,150 per year in increased benefits.

San Diego Police Officer's/ABBE v. City of San Diego

On October 25, 2005 the SDPOA (SDPOA #2) filed a lawsuit against the City alleging failure to pay for overtime work under the Fair Labor Standards Act. The likelihood of an unfavorable outcome is reasonably possible and is estimated to be in the range of $0 - $5,000.

Significant regulatory actions are described below (Other regulatory actions are described in Notes 17 and 22).

IRS Voluntary Correction Program Settlement

SDCERS is operated as a qualified governmental defined benefit plan under Internal Revenue Code (IRC) §§ 401(a) and 414(d). In light of various concerns raised in investigative reports regarding practices of SDCERS that could have jeopardized its status as a qualified governmental defined benefit plan, SDCERS requested its outside tax counsel, Ice Miller LLP, to perform a comprehensive document compliance review, prepare submissions in accordance with the IRS Voluntary Correction Program (VCP), and work with the IRS to finalize a compliance statement to resolve SDCERS' compliance issues. A comprehensive settlement was reached between the IRS and SDCERS on December 20, 2007 (Settlement). The Settlement requires the City and SCDERS to take certain corrective actions, some of which will require Council approval, regarding certain provisions of its retirement plan within 150 days of December 20, 2007. The Settlement does not require the City to pay any penalty payments or to make any additional contributions to the retirement system. In the event the City does not successfully implement certain plan document changes required by the IRS Compliance Statement, SDCERS and the City may face additional regulatory actions from the IRS including but not limited to, SDCERS plan disqualification and financial penalties against the City, the plan sponsor.

The VCP filings identified violations and proposed corrections regarding the City's Presidential Leave Program for presidents of certain labor organizations that represent City employees; compensation limits under IRC § 401(a)(17); minimum distribution requirements under IRC § 401(a)(9); eligible rollover distribution compliance under IRC § 401(a)(31); minimum distribution requirements from the Deferred Retirement Option Plan (DROP) program; overpayment of disability benefits; conversion of annual leave to purchased service credits; retiree healthcare benefits and health administrative expenses under IRC § 401(h); benefit and compensation limits under IRC §§§ 415(b), 415(c) and 415(n); and remedial plan amendments.

The practice of using pension plan assets, and later a bifurcation of City contributions to the pension plan to fund retirement healthcare benefits, resulted in the most significant plan violation in monetary terms. The compliance statement identified that from 1983 through 1991 retiree health benefits were paid by SDCERS when the plan document did not provide for such benefits. Additionally, the compliance statement states that the plan was not appropriately reimbursed for administrative expenses related to the provision of retiree health benefits from 1993 to 2006. Both of these failures were related to non-compliance with IRC § 401(a)(2). The cumulative value of improper payments associated with this failure was approximately $34 million. In a separate failure, the compliance statement also identified that from 1998 through 2005, the terms of the Plan did not comply with all of the provisions of IRC §§ 401(a)2 and 401(h) as it relates to the plan's administration of retirement health benefits and the use of plan earnings to fund the benefits. The compliance statement indicated that the manner in which the benefits were funded "made it extremely difficult, if not impossible to resolve that there was no inappropriate use of the Plan Assets." In this regard, and for the purposes of presenting fairly the effect on net assets, the City has estimated that from 1988 through 2006, the cumulative effect of the improper administration of Retiree Health Benefits was approximately $77.1 million. These amounts will be treated as a reduction to City contributions against its Annually Required Contribution during the year in which the expenditures occurred and instead recorded as part of the City's Net Pension Obligation.

With regard to benefit and compensation limits, in March 2001 the City Council authorized the establishment a Preservation of Benefit Plan. A preservation.of benefit plan is a qualified governmental excess benefit arrangement (QEBA) under IRC § 415(m), which is a vehicle created by Congress to allow the payment of promised pension benefits that exceed the IRC § 415(b) limits. While the City Council approved the establishment of a Preservation of Benefit Plan satisfying the requirements of § 415(m), the City has not received a determination letter from the IRS approving the formation of its Preservation of Benefit Plan QEBA. Under the Internal Revenue Code, the City may not pre-fund the Preservation of Benefit Plan to cover future liabilities beyond the current year, as with the 401(a) plan. Despite the creation of the Preservation of Benefit Plan by the City Council in March 2001, SDCERS continued to treat the excess amounts as payable from the 401(a) plan assets in violation of law. SDCERS did not establish a Preservation of Benefit Plan and Trust until February 2007. In future years, SDCERS will determine the amount necessary to fund any pension benefits payable during the calendar year in excess of the amount permitted by IRC § 415(b). This amount will include the projected amount of all excess pension benefits payable for the calendar year as well as the projected cost of administering the Preservation of Benefit Plan for the calendar year. SDCERS will provide this information to the City and the City will pay these costs on an annual basis. The City transferred money into a new POB account in December 2007 to fund POB payments. With the issuance of the Compliance Statement, SDCERS has stopped paying benefits in excess of the 415(b) limits from the SDCERS Trust Fund. Excess benefits will be paid only from the POB Plan.

The most current estimated actuarially accrued liability related to excess benefits for eligible active members of the system, amounting to approximately $22.8 million, has been excluded from the actuarial valuation of the 401(a) retirement plan beginning in fiscal year 2006 (this liability is estimated to be approximately $30.4 million in the fiscal year 2007 actuarial valuation). Additionally, the liability for retired members of the Preservation of Benefit Plan, amounting to approximately $6.4 million, has been excluded from the fiscal year 2007 actuarial valuation of the 401(a) retirement plan. Accordingly, the liability related to excess benefits for retired members is reflected in the actuarial liabilities of the 401(a) plan in the actuarial valuation dated June 30, 2006 as well as in the ARC payable in fiscal year 2008.

In fiscal year 2005, costs related to the Preservation of Benefit Plan for both retired and active members are included in the actuarial liabilities presented in the Required Supplementary Information (RSI) for the City's core pension plan and are valued using the same set of assumptions. In a review of the financial statements of other local governments, the City has noted significant diversity of practice in how governments are accounting for QEBAs. As such, the City is in the process of implementing a plan to account for the QEBA with SDCERS.

City Attorney Concerns with Pension System

The City Attorney has concluded that, in his opinion, the excess retirement benefits referenced above, require voter approval as such benefits constitute a distinct pension plan not authorized under the City Charter. Therefore, it is also his opinion that the excess retirement benefits are illegal and that the City should immediately discontinue payment. Other members of management believe that this issue has yet to be resolved in court related to lawsuits previously filed by the City Attorney. As such, the City intends to continue to treat these benefits as legal obligations until instructed to do otherwise by a court. In the opinion of management, a decision to terminate such benefits would expose the City's residents to unnecessary and costly legal fees.

In addition, the City Attorney has written to the Internal Revenue Service, in letters dated September 13, 2007, October 3, 2007 and November 6, 2007, expressing his concerns that the pension plan in its current form violates various provisions of the City Charter and the City Municipal Code, and that such violations could jeopardize the status of SDCERS as a qualified governmental defined benefit plan. In addition to matters identified elsewhere in these notes and the IRS Compliance Statement, set forth below are additional concerns raised in such letters or in other public pronouncements of the City Attorney:

1. DROP: The City Attorney has alleged that the DROP program, as discussed in Note 12, is not currently operated on a neutral cost basis. Municipal Code section 24.1401(b) provides that "DROP is intended to be cost neutral." In DROP, the employee's retirement benefit calculation is fixed as of the date of participation and they continue to work for the City up to five years, while their monthly pension benefit is deposited into an individual account held by SDCERS.[1]

2. Purchase of Service Credit Program: Employees hired before July 1, 2005 were permitted to buy pensionable years' service credit below cost; however, such program was also intended to be cost neutral as reflected in a City Manager memorandum to the Council at the time Council approved such program.[1]

3. Term Limit: Elected officials are permitted to buy pensionable years' service credit in excess of the time they are permitted to serve under section 12(f) of the City Charter (two consecutive four-year terms).[2]

4. Pension Plan Vesting Requirement: Employees were allowed credit for pension years purchased below cost to satisfy the retirement plan's 10 year vesting requirement. In relation to non-public safety employees, the Charter provides that "No employee shall be retired before reaching the age of 62 years and before completing 10 years of service for which payment has been made, except such employees may be given the option to retire at the age

[1] As of issuance of this report, these matters are currently on appeal to the California Court of Appeals, Fourth District, and the parties are presently waiting to be apprised of the briefing schedule by the court.

[2] As of issuance of this report, this concern has not been involved in any type of litigation

of 55 years after 20 years of service for which payment has been made with a proportionally reduced allowance".[1]

5. Retirement Age: Non-public safety Employees were permitted to use pension years purchased below cost to retire at 55 rather than 62, without regard to whether they have 20 years of service.[1]

Other members of management believe that the legal status of these matters has not been definitively determined and do not raise IRS qualification issues. Furthermore, other members of management note that while the IRS was made aware of these issues prior to issuing the compliance statement discussed earlier in the note, to date the IRS has not determined to take any action regarding the issues alleged by the City Attorney.

California Regional Water Quality Board Administrative Proceeding

The City is in an on-going administrative proceeding before the California Regional Water Quality Control Board (RWQCB) where it has been alleged that the City, along with eight other entities, have contributed to polluting San Diego Bay, a condition which requires abatement. The allegations relate to current and historic discharges of urban runoff into Chollas Creek, which drains into the San Diego Bay. The City has retained consultants to assess the available data and therefore it is difficult to determine likelihood of an unfavorable outcome. However, the RWQCB has estimated that remediation costs could range between $900 and $122,000 depending on the remedy selected, and the City would have a yet-to-be determined share of those remediation costs if an unfavorable outcome were to happen.

[1] As of issuance of this report, these matters are currently on appeal to the California Court of Appeals, Fourth District, and the parties are presently waiting to be apprised of the briefing schedule by the court.

19. THIRD PARTY DEBT (In Thousands)

The City has authorized the issuance of certain conduit revenue private activity bonds, in its name, to provide tax exempt status because it believes a substantial public benefit will be achieved through the use of the proceeds. Aside from the fact that these bonds have been issued in the City's name, the City has no legal obligation to make payment on these bonds and has not pledged any City assets as a guarantee to the bondholders. The following describes the various types of such third party debt:

Mortgage and Revenue Bonds

Single family mortgage revenue bonds have been issued to provide funds to purchase mortgage loans secured by first trust deeds on newly constructed and existing single-family residences. The purpose of this program is to provide low interest rate home mortgage loans to persons of low or moderate income who are unable to qualify for conventional mortgages at market rates. Multi-family housing revenue bonds are issued to provide construction and permanent financing to developers of multi-family residential rental projects located in the City to be partially occupied by persons of low income.

Industrial Development Revenue Bonds

Industrial Development Revenue bonds have been issued to provide financial assistance for the acquisition, construction, and installation of privately-owned facilities for industrial, commercial or business purposes to mutually benefit the citizens of the City of San Diego.

1911 Act Special Assessment Bonds

1911 Act Special Assessment Bonds have been issued to provide funds for the construction or acquisition of public improvements, and/or the acquisition of property for public purposes, for the benefit of particular property holders within the City. Each bond is secured by a lien on a specific piece of property. The final payment on all outstanding 1911 Act Special Assessment Bonds occurred on December 27, 2005, accordingly, there was no balance outstanding as of June 30, 2006.

As of June 30, 2006, the status of all third party bonds issued is as follows (in thousands):

	Original Amount	Balance June 30, 2006
Mortgage Revenue	$ 132,390	$ 33,320
Industrial Development Revenue	345,805	161,240
1911 Act Special Assessment	236	-
Total	$ 478,431	$ 194,560

These bonds do not constitute an indebtedness of the City. The bonds are payable solely from payments made on and secured by a pledge of the acquired mortgage loans, certain funds and other monies held for the benefit of the bondholders pursuant to the bond indentures, property liens and other loans. In reliance upon the opinion of bond counsel, City officials have determined that these bonds are not payable from any revenues or assets of the City, and neither the full faith nor credit for the taxing authority of the City, the state, or any political subdivision thereof is obligated to the payment of principal or interest on the bonds. In essence, the City is acting as a conduit for the private property owners/bondholders in collecting and forwarding the funds. Accordingly, no liability has been recorded in the City's government-wide statement of net assets.

20. CLOSURE AND POST CLOSURE CARE COST (In Thousands)

State and federal laws and regulations require that the City of San Diego place a final cover on its Miramar Landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for thirty years after closure. Although closure and post closure care costs will be paid only near or after the date that the landfill stops accepting waste, the City reports a portion of these closure and post closure care costs as an operating expense in each period based on landfill capacity used as of each financial statement date.

The $14,811 reported as landfill closure and post closure care liability at June 30, 2006 represents the cumulative amount reported to date based on the use of 81.6% of the estimated capacity of the landfill.

The City will recognize the remaining estimated cost of closure and post closure care of $3,294 as the remaining estimated capacity is filled. These amounts are based on what it would cost to perform all closure and post-closure care at June 30, 2006. The City expects to close the landfill in fiscal year 2012. Actual costs may be higher due to inflation, changes in technology, or changes in regulations.

The City is required by state and federal laws and regulations to make annual contributions to finance closure and post-closure care. The City is in compliance with these requirements and at June 30, 2006, cash or equity in pooled cash and investments of $31,814 was held for this purpose. This is reported as restricted assets on the statement of net assets in the Environmental Services Fund. The City expects that future inflation costs will be paid from interest earnings on these annual contributions. However, if interest earnings are inadequate or additional post-closure care requirements are determined (due to changes in technology or applicable laws or regulations, for example), these costs may need to be paid by charges to future landfill users or from other sources.

21. OPERATING AGREEMENTS (In Thousands)

San Diego Data Processing Corporation and Automated Regional Justice Information System

On October 22, 2001, SDDPC renewed its fiscal year 2002 agreement with a joint powers agency known as the Automated Regional Justice Information System ("ARJIS") whose main purpose is to pursue development of computerized law enforcement systems in the region.

Under the agreement, SDDPC is to provide data processing services to ARJIS at rates which, on an annual basis, are equivalent to those charged to other governmental entity clients. Included in SDDPC's data processing services revenue is approximately $2,624 related to ARJIS for the year ended June 30, 2006.

City of San Diego and San Diego Medical Services Enterprise, LLC

On July 1, 1997, the City entered into an operating agreement with Rural/Metro Corporation, a provider of emergency medical transport services, to form San Diego Medical Services Enterprise, LLC (SDMSE) for the purpose of providing the City with emergency medical and medical transportation services. The operating agreement and related contracts to provide such services were renewed on July 1, 2002 and again on July 1, 2005. The operating agreement will expire on June 30, 2008 unless SDMSE is awarded a new contract after a competitive bidding process. SDMSE made a profit distribution to its partners of $455 during fiscal year 2006.

City of San Diego and Padres L.P.

On February 1, 2000, the City entered into a Joint Use and Management Agreement (Agreement) with the San Diego Padres baseball team (Padres) governing the rights and duties of the City and Padres with respect to the use and operation of the new Petco Park Ballpark Facility (Facility). The Facility was completed and operational in April 2004. The City and Padres jointly own the facility; the Padres having a 30% divided interest based upon the original Facility cost estimate of $267,500 (or $80,250) with the City owning 70% which is capitalized on the City's books. The City and the Padres have agreed upon the schedule of items and components that constitute the Padres' divided ownership, and the value of that divided ownership may vary from (but does not exceed) 30% due to the calculation of cost overruns for the Ballpark. Following termination of any occupancy agreement for the Ballpark, the Padres' ownership interest will automatically transfer to the City. Under the terms of the Agreement, the Padres are responsible for Facility operation and management, including maintenance, repairs and security required to preserve its condition. The City is responsible for paying certain expenses associated with the operation and maintenance of the Facility, up to a maximum of $3,500 per year, subject to certain inflationary adjustments.

22. SUBSEQUENT EVENTS (In Thousands)

On July 3, 2006, the City privately placed a fiscal year 2006-2007 Tax Revenue Anticipation Note in an amount not to exceed $142,000, to meet certain general fund cash flow needs of the City. The fiscal year 2006-2007 Tax Revenue Anticipation Note was repaid in August 2007.

On July 13, 2006, the City issued, on a private placement basis, $16,000 of Community Facilities District No. 3 Special Tax Bonds to finance public improvements required in connection with the district. The Series 2006 A bonds were issued pursuant to the Mello-Roos Community Facilities Act of 1982 and are limited obligations of the district. The bonds were structured as five term bonds, and were issued on a fixed rate basis. The fixed rate on the term bonds range from 5.0% to 5.75%, and the final maturity date is September 1, 2036.

On August 6, 2006 a lawsuit was filed following a water main break which caused flooding along a private street in the Colony Hills Homeowners Association (HOA) in La Jolla. Claimants allege the water main failure caused soil subsidence, hillside failure, road failure and diminished property values of 40 HOA homes. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of $0 - $40,000.

On August 6, 2006 a lawsuit arose following a traffic accident between plaintiffs and a San Diego Police officer. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of $0 - $1,500.

On October 17, 2006, the City Council authorized the 2nd and 3rd Amendments to the Master Lease Agreement with Banc of America Leasing and Capital, LLC. The 2nd Amendment to the Master Lease Agreement authorizes the lease-purchase of Motive Equipment in an amount not to exceed $6,800. The 3rd Amendment to the Master Lease Agreement authorizes the lease-purchase of Fire Apparatus in an amount not to exceed $2,550.

On October 2, 2006, Ace Properties entered into an inverse condemnation case against the City of San Diego. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of $0 - $3,000.

On October 31, 2006, the Redevelopment Agency of the City of San Diego issued a non-revolving line of credit with Bank of America, N.A. for an aggregate amount of $10,000, comprised of a tax-exempt commitment of $7,534 and a taxable commitment of $2,466. The line of credit is to be used to refinance the North Park Theatre, to pay sums of settlement of eminent domain actions relating to the North Park Redevelopment Area and for other redevelopment activities in the North Park Redevelopment Area. The interest rate on the tax-exempt advances will be at a rate per year equal to 62.347% of the LIBOR Rate plus .90% and the interest rate on the taxable advances will be at a rate per year equal to the LIBOR Rate plus 1.20%, unless the Agency elects to have any of the tax-exempt or taxable advances bear interest at a rate based on the Bank's Prime Rate. The maturity date will be November 1, 2008, unless the Agency issues bonds, notes or other obligations for the North Park Project Area prior to the maturity date.

On December 1, 2006, the Governmental Accounting Standards Board issued GASB 49. Reflecting its intention to ensure that costs and liabilities not specifically addressed by current governmental accounting standards are included in financial reports, the GASB issued a standard that will require state and local governments to provide the public with more extensive information about the financial impact of environmental cleanups effective for financial statements issued for fiscal year 2009. The City has not at this time determined the impact of this accounting standard on its financial statements.

On January 9, 2007, the City Council authorized the Mayor to execute a fifteen-year loan agreement with the California Energy Resources Conservation and Development Commission in the amount of $2,227 at the rate of 4.5% interest, to upgrade mechanical and electrical systems at multiple City facilities to more energy efficient systems. The effective date of the loan agreement or the date that the loan agreement was executed by both parties was March 3, 2007.

On January 30, 2007, the Public Facilities Financing Authority of the City of San Diego issued, on a private placement basis, $57,000 of Non-Transferable Subordinated Water Revenue Notes to finance upgrades to and expansion of the City's water system and to reimburse for previous costs incurred. The Series 2007A Notes are secured by and payable solely from net system revenues of the Water Utility Fund. The 2007A Notes bear an interest rate of 4.06%, and the maturity date is January 30, 2009.

On March 7, 2007, Grace Church of North County filed a claim against the City alleging State and Federal constitutional violations arising from the City's approval of a five year permit instead of the requested ten year permit. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of $0 – $2,000.

On March 12, 2007, the Public Facilities Financing Authority of the City of San Diego issued, on a private placement basis, $156,560 of Lease Revenue Refunding Bonds to refund the existing Public Facilities Financing Authority Ballpark Lease Revenue Bonds, Series 2002. The Series 2007A Bonds are secured by and payable solely from base rental payments payable under the Ballpark Facility Lease. Such base rental payments are a general fund obligation of the City. The interest rates range from 5.0% to 5.25%, and the final maturity date is February 15, 2032.

On March 21, 2007, the City received a State Revolving Fund Loan disbursement from the State of California Water Resources Control Board totaling $3,858 for the Point Loma Fourth Sludge Pump Modifications Project. The repayment period for the loan is 20 years, which begins one year after the completion of the project. The City is required to provide a 16.667% match for the loan, resulting in an effective interest rate of 2.42%.

On March 27, 2007, the Council authorized a Master Lease Agreement with Koch Financial Corporation for the lease-purchase of Motive Equipment and Public Safety Equipment in an amount not to exceed $14,600.

On May 7, 2007, the Public Facilities Financing Authority of the City of San Diego issued, on a private placement basis, $223,830 of Subordinate Sewer Revenue Notes, Series 2007 to finance and reimburse for previous costs incurred from upgrades to the City's sewer system and to refund the outstanding balance on the Series 2004 Subordinated Bonds in the amount of $144,400. The Series 2007 Notes are secured by and payable solely from net system revenues of the Sewer Utility Fund. The notes bear an interest rate of 5.00%, and the maturity date is May 15, 2009.

On May 15, 2007, the Council authorized a Master Lease Agreement with IBM Credit LLC for the lease-purchase of the Enterprise Resource Planning System in an amount not to exceed $29,500.

On July 2, 2007, the City privately placed a fiscal year 2007-2008 Tax Revenue Anticipation Note in an amount not to exceed $116,000 to meet general fund cash flow needs of the City. The City borrowed $116,000 on July 2, 2007 on a 13 month term.

On July 12, 2007, the Public Facilities Financing Authority issued $17,230 Series 2007A taxable pooled financing bonds for Southcrest, Central Imperial and Mount Hope Redevelopment Projects and $17,755 Series 2007B tax-exempt pooled financing Bonds for Southcrest and Central Imperial Redevelopment Projects. The Series A and Series B together were issued to make loans to the Redevelopment Agency of the City of San Diego to be used for financing and refinancing redevelopment activities in the Southcrest, Central Imperial and Mount Hope Redevelopment Project Areas. The issuance was through a public offering. The Series 2007 A and 2007 B Bonds are secured by a Loan Agreement and a Second Supplemental Trust Agreement (Central Imperial Redevelopment Project Area) and a Third Supplemental Trust Agreement (Southcrest Redevelopment Project Area) and a Fourth Supplemental Trust Agreement (Mount Hope Redevelopment Area) and are payable solely from the tax increment revenues derived from each project area. The fixed rate on the term bonds range from 4.0% to 6.65%, and the final maturity date is October 1, 2037.

On July 26, 2007, the Redevelopment Agency of the City of San Diego executed six separate non-revolving secured three-year term taxable and tax-exempt lines of credit with San Diego National Bank. Four taxable lines of credit are for affordable housing in North Park, City Heights, North Bay and Naval Training Center (NTC) Redevelopment Project Areas for an aggregate of $34,000. The two additional lines of credit are for non-housing or general purpose for City Heights, which is a taxable line of credit of $20,000 and NTC Redevelopment Project, which is taxable for $6,000 and tax-exempt for $10,000. The Agency may elect to have the taxable advance bear interest at a fixed rate equal to the United States Three-Year Treasury Constant Maturities Index plus 1.90%, which will remain fixed for the entire period of such advance or elect to have the interest set at a fixed rate equal to the One-Month LIBOR Rate plus 1.10%. Tax-exempt advances will bear interest at a fixed rate determined by adding .70% to the product of the One-Month LIBOR Rate multiplied by 90%. Interest will be payable quarterly in arrears along with a .45% per annum loan fee on the unused commitment. Principal is due at maturity with no prepayment penalty.

On September 28, 2007, several current firefighters for the City of San Diego filed suit against the City of San Diego Fire Department alleging sexual harassment, failure to prevent harassment, retaliation, emotional distress and violation of freedom of speech experienced during the 2007 Gay Pride Parade in San Diego. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of $0 - $3,000.

On October 3, 2007 there was a landslide in La Jolla on Soledad Mountain Road. The cause of the landslide is under investigation by a geological consulting group, and has not been identified as of the issuance of this report.

On October 21, 2007, multiple wild fires began burning throughout the county of San Diego. Fueled by dry Santa Ana winds, these fires prompted the evacuation of an estimated 500,000 residents. As of the issuance of this report, the City estimates that the fire related costs are approximately $24,000. The City has received cash advances of $4,800 to reimburse a portion of these costs and expects to receive additional reimbursements from federal and state agencies and other sources ranging from $0 - $16,000.

On January 18, 2008, the City Council approved, by majority vote, to enter into a plan to pre-fund expenses related to other post employment benefits. The plan, administered by CalPERS, requires the City to pre-fund the plan in an amount not less than $5,000 annually; however, the City intends to make annual contributions to the plan in an amount not less than 50% of the Annual Required Contribution, as calculated by an actuary of the City's choice.

On February 28, 2008, the Public Facilities Financing Authority of the City of San Diego issued, on a private placement basis, $150,000 of Subordinated Water Revenue Notes to finance the acquisition and construction of the City's water system and to reimburse for previous costs incurred. The Series 2008A Notes are secured by and payable solely from net system revenues of the Water Utility Fund. The 2008A Notes bear an interest rate of 3.28%, and the maturity date is August 28, 2009.

Required Supplementary Information
(Unaudited)
Pension Trust Funds Analysis of Funding Progress

The following table shows the funding progress of the full City's portion of SDCERS (excluding the Port and the Airport) for the last three fiscal years (in thousands):

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability ** PUC * (b)	UAAL** (b - a)	Funded Ratio ** (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b – a)/c)
6/30/2004	$ 2,628,680	$ 4,077,833	$ 1,449,153	64.46%	$ 540,181	268.27%
6/30/2005	2,983,080	4,436,017	1,452,937	67.25%	557,631	260.56%
6/30/2006	3,981,932	4,982,700	1,000,768	79.92%	534,103	187.37%

* Projected Unit Credit method used for determining actuarial accrued liability.

** For fiscal years 2004 and 2005, the actuarial accrued liability, UAAL, and funded ratio have been adjusted to reflect the impact of the Corbett contingent benefit. The Actuarial Valuations provided by the actuary for these years do not include this contingent benefit in the funded ratio. However, the valuation prepared by the actuary for fiscal year 2006 does include the impact of the Corbett contingent benefit.

STATISTICAL SECTION [NOT AUDITED]

City of San Diego
Pledged-Revenue Coverage - Water Bonds (Unaudited)
Last Ten Fiscal Years (In Thousands)

Fiscal Year Ended June 30	Total Income	Total Expenses	Net System Revenue	Less: Interest Earnings on Reserve Fund - Parity Obligations	Adjusted Net System Revenue
1999	$ 210,490	$ 195,407	$ 15,083	$ (884)	$ 14,199
2000	255,736	213,358	42,378	-	42,378
2001	255,974	214,056	41,918	(54)	41,864
2002	261,333	222,104	39,229	(3,444)	35,785
2003	256,968	226,058	30,910	(1,305)	29,605
2004	267,649	232,193	35,456	(1,296)	34,160
2005	294,904	234,392	60,512	(1,262)	59,250
2006	303,453	242,180	61,273	(1,228)	60,045

Note: The Water Utility had no bonded debt for fiscal years 1997-1998.

Source: previously published CAFR Reports (2004-05 and prior)

Table 13-1

Debt Service					
Principal	Interest	Total	Less: Parity Interest Earnings	Adjusted Debt Service	Adjusted Debt Service Coverage
$ -	$ 9,365	$ 9,365	$ (884)	$ 8,481	1.67
-	18,730	18,730	-	18,730	2.26
-	18,730	18,730	(54)	18,676	2.24
6,780	18,594	25,374	(3,444)	21,930	1.63
7,055	16,308	23,363	(1,305)	22,058	1.34
7,345	14,010	21,355	(1,296)	20,059	1.70
7,645	13,710	21,355	(1,262)	20,093	2.95
7,965	13,390	21,355	(1,228)	20,127	2.98

[EXCERPTS FROM THE AUDITED FINANCIAL STATEMENTS OF THE CITY OF SAN DIEGO FOR FISCAL YEAR 2006-07 TO BE INSERTED WHEN AVAILABLE]

APPENDIX E

SUMMARY OF PRINCIPAL LEGAL DOCUMENTS

The following is a summary of certain definitions and provisions set forth in the Indenture, the Amended and Restated Master Installment Purchase Agreement, the 2009A Supplement to the Master Installment Purchase Agreement and the Assignment Agreement relating to the Series 2009A Bonds. The Series 2009A Bonds are described in this Summary as the "2009A Bonds." These summaries do not purport to be comprehensive, and reference should be made to such documents for a full and complete statement of such definitions and provisions. Copies of these documents are available from the Trustee.

INDENTURE

The Indenture sets forth certain terms of the Bonds, the nature and extent of the security for the Bonds, the rights of the Owners of the Bonds, rights, duties and immunities of the Trustee and the rights and obligations of the Authority. Certain provisions of the Indenture are summarized below. Other provisions are summarized in the body of this Official Statement under the captions, "DESCRIPTION OF THE SERIES 2009A BONDS" and "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2009A BONDS." Capitalized terms used in connection with the Indenture but not defined below have the meanings ascribed thereto in the body of this Official Statement; certain capitalized terms are defined herein following the description of the Indenture, in connection with the description of the Installment Purchase Agreement. The term "Bonds" initially refers to the Series 2009A Bonds.

Selected Definitions

Additional Bonds

The term "Additional Bonds" means those Bonds authorized and issued hereunder on a parity with the 2009A Bonds, in accordance with Indenture.

Authorized Denominations

The term "Authorized Denominations" means, with respect to the Bonds, $5,000 and any integral multiple thereof and with respect to any Additional Bonds, the authorized denominations specified in a Supplemental Indenture related to such Additional Bonds.

Beneficial Owners

The term "Beneficial Owners" means those individuals, partnerships, corporations or other entities for whom the Participants have caused the Depository to hold Book-Entry Bonds.

Board

The term "Board" means the Board of Commissioners of the Authority.

Bond Counsel

The term "Bond Counsel" means a firm of attorneys that are nationally recognized as experts in the laws governing and relating to municipal finance.

Bond Law

The term "Bond Law" means the Marks-Roos Local Bond Pooling Act of 1985, as amended, being Section 6584 *et seq.* of the Government Code of the State.

Book-Entry Bonds

The term "Book-Entry Bonds" means Bonds executed and delivered under the book-entry system described in the Indenture.

Business Day

The term "Business Day" means a day of the year other than Saturday or Sunday, or a day on which banking institutions located in California are required or authorized to remain closed, or on which the New York Stock Exchange is closed. If the date for making any payment or the last date for performance of any act or the exercising of any right, as provided in the Indenture, shall not be a Business Day, such payment may be made or act performed or right exercised on the next succeeding Business Day, with the same force and effect as if done on the nominal date provided in the Indenture, and, unless otherwise specifically provided in the Indenture, no interest shall accrue for the period from and after such nominal date.

Certificate of the Authority

The term "Certificate of the Authority" means an instrument in writing signed by the Chair, the Vice Chair or the Secretary of the Authority, or by any other officer of the Authority duly authorized by the Authority for that purpose. If and to the extent required by the provisions of the Indenture, each Certificate of Authority shall include the statements provided for in the Indenture.

Certificate of the City

The term "Certificate of the City" means an instrument in writing signed by the Chief Financial Officer, the Chief Operating Officer or any of their respective designees.

Charter

The term "Charter" means the Charter of the City as it now exists or may be amended, and any new or successor Charter.

Closing Date

The term "Closing Date" means any date upon which a Series of Bonds is purchased; the term "2009A Closing Date" means [January __,] 2009.

Code

The term "Code" means the Internal Revenue Code of 1986, as amended, and the regulations thereunder, and any successor laws or regulations.

Components; Refunded Components.

The term "Components" means components of the Project for which the City makes Installment Payments or Subordinated Installment Payments pursuant to any Supplement. The term "Refunded Components" means the Components originally financed with the proceeds of the Refunded Certificates and the Series 2007A Subordinated Notes, which are being refunded with the proceeds of sale of the 2009A Bonds.

Comptroller

The term "Comptroller" means the Comptroller of the City.

Corporate Trust Office of the Trustee

The term "Corporate Trust Office of the Trustee" means the corporate trust office of the Trustee at the address set forth in the Indenture or such other or additional offices as may be specified to the Authority by the Trustee in writing.

Costs of Issuance

The term "Costs of Issuance" means all items of expense directly or indirectly payable by or reimbursable to the City, the Corporation or the Authority relating to the issuance, sale and delivery of any Bonds hereunder, including but not limited to, costs of preparation and reproduction of documents; fees and expenses of the Feasibility Consultant; fees and expenses of the Authority (including its counsel); expenses of City, Authority and Corporation staff; fees of the City's Financial Advisor; initial fees, expenses and charges of the Trustee (including its counsel); Rating Agency fees; Underwriters' discount; legal fees and charges of Bond Counsel, Disclosure Counsel, Underwriters' counsel, and the City Attorney; and any other cost, charge or fee in connection with the issuance and delivery of the Bonds.

Costs of Issuance Account

The term "Costs of Issuance Account" means the account by that name established within the Acquisition Fund under the Indenture, for the payment of Costs of Issuance.

Depository

The term "Depository" means the securities depository acting as Depository pursuant to the Indenture.

DTC

The term "DTC" means The Depository Trust Company, New York, New York, and its successors.

Event of Default

The term "Event of Default" shall have the meaning set forth in the Indenture, as described below.

Feasibility Consultant

The term "Feasibility Consultant" means the consultant who, or whose firm, provides services to the City respecting the future ability of Project components being acquired, installed or constructed with proceeds of sale of the Bonds to generate sufficient Net System Revenues to permit the City to incur Additional Obligations, as set forth in the Agreement.

Federal Securities

The term "Federal Securities" means the following securities:

(1) United States Treasury Bills, bonds, and notes for which the full faith and credit of the United States are pledged for payment of principal and interest;

(2) Direct senior obligations issued by the following agencies of the United States Government: the Federal Farm Credit Bank System, the Federal Home Loan Bank System, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Tennessee Valley Authority;

(3) Mortgage Backed Securities (except stripped mortgage securities) issued by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Government National Mortgage Association; and

(4) United States Treasury Obligations, State and Local Government Series.

Fiscal Year

The term "Fiscal Year" means the fiscal year of the Authority which, as of the date hereof, is the period from July 1 to and including the following June 30.

Fitch

The term "Fitch" means Fitch Ratings and its successors, and if such company shall for any reason no longer perform the functions of a securities rating agency, "Fitch" shall be deemed to refer to any nationally recognized securities rating agency designated by the Authority and the City.

Information Services

Information Services being Financial Information, Inc.'s "Daily Called Bond Service," 30 Montgomery Street, 10th Floor, Jersey City, New Jersey 07302, Attention: Editor; Moody's "Municipal and Government," 99 Church Street, 8th Floor, New York, New York 10007, Attention: Municipal News Reports; and Xcitek's "Called Bond Service," 5 Hanover Square, New York, New York 10004, Attention: Bond Redemption Group; provided, however, in accordance with then current guidelines of the Securities and Exchange Commission, Information Services shall mean such other organizations providing information with respect to called bonds as the Authority may designate in writing to the Trustee.

Interest Account

The term "Interest Account" means the account by that name established under the Indenture.

Interest Payment Date

The term "Interest Payment Date" means August 1, 2009, and each February 1 and August 1 thereafter until the Bonds are paid or redeemed in full.

Letter of Representations

The term "Letter of Representations" means the letter of the Authority delivered to and accepted by the Depository on or prior to the delivery of any Book-Entry Bonds setting forth the basis on which the Depository serves as depository for such Book-Entry Bonds, as originally executed or as it may be supplemented or revised or replaced by a letter to a substitute Depository.

Moody's

The term "Moody's" means Moody's Investors Service, a corporation organized and existing under the laws of the State of Delaware, and its successors, and if such corporation shall for any reason no longer perform the functions of a securities rating agency, "Moody's" shall be deemed to refer to any other nationally recognized securities rating agency designated by the Authority and the City.

Nominee

The term "Nominee" means the nominee of the Depository, which may be the Depository, as determined from time to time pursuant to the Indenture.

Outstanding

The term "Outstanding," when used as of any particular time with reference to Bonds, means (subject to the provisions of the Indenture) all Bonds theretofore or thereupon executed by the Authority and authenticated and delivered by the Trustee pursuant to the terms hereof, except:

(1) Bonds theretofore cancelled by the Trustee or surrendered to the Trustee for cancellation;

(2) Bonds paid or deemed to have been paid within the meaning of the Indenture;

(3) Bonds beneficially owned by the City or the Authority; and

(4) Bonds in lieu of or in substitution for which other Bonds shall have been executed by the Authority and authenticated and delivered pursuant to the terms of the Indenture.

Outstanding Parity Obligations

The term "Outstanding Parity Obligations" means the outstanding principal amount of the San Diego Facilities and Equipment Leasing Corporation Certificates of Undivided Interest (In Installment Payments Payable from the Net System Revenues of the Water Utility Fund of the City of San Diego) Series 1998, following the refunding described in this Official Statement.

Outstanding Subordinated Bonds

The term "Outstanding Subordinated Bonds" means the outstanding principal amount of the Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Bonds, Series 2002 (Payable Solely From Subordinated Installment Payments Secured By Net System Revenues of the Water Utility Fund).

Outstanding Subordinated Notes

The term "Outstanding Subordinated Notes" means the Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Notes, Series 2008A (Payable Solely From Subordinated Installment Payments Secured By Net System Revenues of the Water Utility Fund).

Owner

The term "Owner" means any Person who shall be the registered owner of any Outstanding Bond, as shown on the registration books required to be maintained by the Trustee pursuant to the Indenture.

Parity Obligations

The term "Parity Obligations" means any Obligations payable from Net System Revenues that are secured by a first priority lien on Net System Revenues and are senior in priority to payment of Subordinated Installment Payments.

Participants

The term "Participants" means those broker-dealers, banks and other financial institutions from time to time for which the Depository holds Book-Entry Bonds as securities depository.

Payment Fund

The term "Payment Fund" means the fund by that name established under the Indenture.

Permitted Investments

The term "Permitted Investments" means any of the following to the extent then permitted by law and the Indenture:

(1) Federal Securities;

(2) Obligations of any state, territory or commonwealth of the United States of America or any political subdivision thereof or any agency or department of the foregoing; provided, that at the time of their purchase such obligations are rated "AAA" by two Rating Agencies;

(3) Bonds, notes, debentures or other evidences of indebtedness issued or guaranteed by any corporation which are, at the time of purchase, rated by each Rating Agency in their respective highest short-term rating categories, or, if the term of such indebtedness is longer than three years, rated "AAA" by two Rating Agencies;

(4) Taxable commercial paper or tax-exempt commercial paper with a maturity of not more than 270 days, rated "A1/P1/F1" by two Rating Agencies;

(5) Deposit accounts or certificates of deposit, whether negotiable or non-negotiable, issued by a state or national bank (including the Trustee) or a state or federal savings and loan association or a state-licensed branch of a foreign bank; provided, however, that such certificates of deposit or deposit accounts shall be either (a) continuously and fully insured by the Federal Deposit Insurance Corporation; or (b) have maturities of not more than 365 days (including certificates of deposit) and are issued by any state or national bank or a state or federal savings and loan association, the short-term obligations of which are rated in the highest short term letter and numerical rating category by two Rating Agencies;

(6) Bills of exchange or time drafts drawn on and accepted by a commercial bank, otherwise known as bankers acceptances, which bank has short-term obligations outstanding which are rated by two Rating Agencies in their respective highest short-term rating categories, and which bankers acceptances mature not later than 180 days from the date of purchase;

(7) Any repurchase agreement with any bank or trust company organized under the laws of any state of the United States or any national banking association (including the Trustee), or a state-licensed branch of a foreign bank, having a minimum permanent capital of one hundred million dollars ($100,000,000) and with short-term debt rated by two Rating Agencies in their respective three highest short-term rating categories or any government bond dealer reporting to, trading with, and recognized as a primary dealer by, the Federal Reserve Bank of New York, which agreement is secured by any one or more of the securities and obligations described in clause (1) of this definition, which shall

have a market value (valued at least weekly) not less than 102% of the principal amount of such investment and shall be lodged with the Trustee, the Treasurer or other fiduciary, as custodian for the Trustee, by the bank, trust company, national banking association or bond dealer executing such repurchase agreement. The entity executing each such repurchase agreement required to be so secured shall furnish the Trustee with an undertaking satisfactory to it that the aggregate market value of all such obligations securing each such repurchase agreement (as valued at least weekly) will be an amount equal to 102% the principal amount of such repurchase agreement and the Trustee shall be entitled to rely on each such undertaking;

(8) Any cash sweep or similar account arrangement of or available to the Trustee, the investments of which are limited to investments described in clauses (1), (2) and (7) of this definition and any money market fund, the entire investments of which are limited to investments described in clauses (1), (2) and (7) of this definition and which money market fund is rated in their respective highest rating categories by two Rating Agencies;

(9) Any guaranteed investment contract, including forward delivery agreements ("FDAs") and forward purchase agreements ("FPAs"), with a financial institution or insurance company which has at the date of execution thereof an outstanding issue of unsecured, uninsured and unguaranteed debt obligations or a claims-paying ability rated within the two highest rating categories of two or more Rating Agencies. Only Permitted Investments described in clause (1) above and having maturities equal to or less than 30 years from their date of delivery will be considered eligible for any collateralization/delivery purposes for guaranteed investment contracts, FDAs or FPAs;

(10) Certificates, notes, warrants, bonds or other evidence of indebtedness of the State or of any political subdivision or public agency thereof which are rated in the highest short-term rating category or within one of the three highest long-term rating categories of two Rating Agencies (excluding securities that do not have a fixed par value and/or whose terms do not promise a fixed dollar amount at maturity or call date);

(11) For amounts less than $10,000, interest-bearing demand or time deposits (including certificates of deposit) in a nationally or state-chartered bank, or a state or federal savings and loan association in the State, fully insured by the Federal Deposit Insurance Corporation, including the Trustee or any affiliate thereof;

(12) Investments in taxable money market funds or portfolios restricted to obligations with an average maturity of one year or less and which funds or portfolios are rated in either of the two highest rating categories by two Rating Agencies or have or are portfolios guaranteed as to payment of principal and interest by the full faith and credit of the United States of America;

(13) Investments in the City's pooled investment fund;

(14) Investments in the Local Agency Investment Fund created pursuant to Section 16429.1 of the Government Code of the State;

(15) Shares of beneficial interest in diversified management companies investing exclusively in securities and obligations described in clauses (1) through (12) of this definition and which companies are rated in their respective highest rating categories by two Rating Agencies or have an investment advisor registered with the Securities and Exchange Commission with not less than five years' experience investing in such securities and obligations and with assets under management in excess of five hundred million dollars ($500,000,000); and

(16) Shares in a California common law trust established pursuant to Title 1, Division 7, Chapter 5 of the Government Code of the State which consists exclusively of investments permitted by Section 53601 of Title 5, Division 2, Chapter 4 of the Government Code of the State, as it may be amended.

Person

The term "Person" means any legal entity or natural person, as the context may require.

Pre-Refunded Municipals

The term "Pre-Refunded Municipals" means any bonds or other obligations of any state of the United States of America or of any agency, instrumentality or local governmental unit of any such state which are not callable at the option of the obligor prior to maturity or as to which irrevocable instructions have been given by the obligor to call on the date specified in the notice.

Principal Account

The term "Principal Account" means the account of that name established under the Indenture.

Principal Payment Date

The term "Principal Payment Date" means each August 1, commencing August 1, 20__ through and including August 1, 2038.

Project

The term "Project" means the acquisition, construction, installation and improvements to the Water System described in Exhibit A to the Agreement and as modified with respect to Components in conformance with the Agreement.

Purchase Price

The term "Purchase Price" means the principal amount plus interest thereon owed by the City under the terms of the Agreement as provided in the Indenture thereof and as specified in a Supplement.

Rating Agency

The term "Rating Agency" means Fitch, Moody's or S&P.

Rebate Fund

The term "Rebate Fund" means the fund by that name created under the Indenture and any other accounts thereunder.

Record Date

The term "Record Date" means the fifteenth day of the calendar month immediately preceding an Interest Payment Date, whether or not such day is a Business Day.

Redemption Account

The term "Redemption Account" means the account by that name established under the Indenture.

Refunded Certificates

The term "Refunded Certificates" means those maturities of the San Diego Facilities and Equipment Leasing Corporation Certificates of Undivided Interest (In Installment Payments Payable from the Net System Revenues of the Water Utility Fund of the City of San Diego) Series 1998 to be refunded with a portion of the proceeds of the 2009A Bonds.

Refunded Obligations

The term "Refunded Obligations" means the Refunded Certificates and the Series 2007A Subordinated Notes paid or called and refunded with portions of the proceeds of the Bonds.

Representative

The term "Representative" means Morgan Stanley & Co. Incorporated, as representative of the several Underwriters of the 2009A Bonds.

Requisition

The term "Requisition" means a requisition form, by which the City shall withdraw moneys from the Acquisition Fund or the Costs of Issuance Account.

[Reserve Fund]

[The term "Reserve Fund" means the fund by that name established under the Indenture, in which the Reserve Requirement shall be held and invested.]

[Reserve Requirement; 2009A Reserve Requirement]

[The term "Reserve Requirement" means, as of any date of calculation, the least of (i) ten percent (10%) of the proceeds (within the meaning of section 148 of the Code) of the Bonds; (ii) 125% of average annual debt service on the then-Outstanding Bonds; or (iii) the Maximum Annual Debt Service for that and any subsequent year. [The term "2009A Reserve Requirement" shall mean, initially, the sum of $__________.] Upon early redemption of any of the Bonds, the Authority, at the request of the City, may request the Trustee to recalculate and reduce any Reserve Requirement, whereupon any excess in the Reserve Fund over and above such Reserve Requirement shall be transferred to the Payment Fund.]

Revenues

The term "Revenues" means all Series 2009A Installment Payments received by or due to be paid to the Corporation pursuant to the 2009A Supplement, and the interest or profits from the investment of money in any account or fund (other than the Rebate Fund) pursuant to the Indenture.

S&P

The term "S&P" means Standard & Poor's Ratings Group, a division of The McGraw-Hill Companies, Inc., a corporation organized and existing under the laws of the State of New York, and its successors, and if such corporation shall for any reason no longer perform the functions of a securities rating agency, "S&P" shall be deemed to refer to any other nationally recognized securities rating agency designated by the Authority and the City.

Securities Depository

The term "Securities Depository" means The Depository Trust Company, 55 Water Street, 50th Floor, New York, N.Y. 10041-0099 Attn. Call Notification Department, Fax (212) 855-7232, or, in accordance with then-current guidelines of the Securities and Exchange Commission, such other securities depositories, or no such depositories, as the Authority may indicate in a Written Request of the Authority delivered to the Trustee.

Series 2007A Subordinated Notes

The term "Series 2007A Subordinated Notes" means the Public Facilities Financing Authority of the City of San Diego Non–Transferable Subordinated Water Revenue Notes, Series 2007A (Payable Solely From Subordinated Installment Payments Secured By Net System Revenues of the Water Utility Fund), in the original principal amount of $57,000,000.

Series 2008A Subordinated Installment Payments

The term "Series 2008A Subordinated Installment Payments" means the Series 2008A Subordinated Installment Payments specified in Section 4.01 of the 2008A Supplement.

Series 2008A Subordinated Notes

The term "Series 2008A Subordinated Notes" means the Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Notes, Series 2008A (Payable Solely From Subordinated Installment Payments Secured By Net System Revenues of the Water Utility Fund), in the original principal amount of $150,000,000.

State

The term "State" means the State of California.

Subordinated Installment Payments

The term "Subordinated Installment Payments" means Installment Payments that are Subordinated Obligations (as defined in the Agreement), scheduled to be paid by the City under and pursuant to any Supplement that has been assigned to the Trustee (as assignee of the Authority) to secure any Subordinated Bonds or Notes.

Supplement

The term "Supplement" means a supplement providing for the payment of specific Installment Payments as the Purchase Price for Components of the Project, executed and delivered by the City and the Corporation.

2007 Supplement

The term "2007 Supplement" means the 2007A Supplement to the Agreement, by and between the City and the Corporation, dated as of January 1, 2007.

2009A Installment Payments

The term "2009A Installment Payments" means those Installment Payments scheduled to be paid by the City under the 2009A Supplement.

2009A Supplement

The term "2009A Supplement" means the 2009A Supplement to the Agreement, by and between the City and the Corporation, dated as of January 1, 2009.

Supplemental Indenture

The term "Supplemental Indenture" means any indenture supplemental hereto or amendatory hereof duly executed and delivered by the Authority and the Trustee as authorized hereunder.

Surety Bond

The term "Surety Bond" means a reserve surety bond, insurance policy, letter of credit or other similar instrument providing, by its terms, a stated amount as a credit towards or in satisfaction of all or part of the Reserve Requirement, which shall be held by the Trustee in trust, pursuant to the Indenture.

Tax Certificate

The term "Tax Certificate" means the Tax Exemption Certificate delivered with respect to Tax-Exempt Bonds on their Closing Date.

Tax Code

The term "Tax Code" means the Internal Revenue Code of 1986, as amended, and the Regulations promulgated by the Internal Revenue Service pursuant thereto.

Tax-Exempt Bonds

The term "Tax-Exempt Bonds" means those Bonds which, by their terms, bear interest that is excluded from gross income for federal income tax purposes, pursuant to the Tax Code.

Treasurer

The term "Treasurer" means the Office of the City Treasurer of the City of San Diego.

1998 Trust Agreement

The term "1998 Trust Agreement" means that certain Trust Agreement, dated as of August 1, 1998, by and among the City, the Corporation and the 1998 Trustee, pursuant to which the Refunded Certificates were executed and delivered.

Trustee

The term "Trustee" means Wells Fargo Bank, National Association, a national banking association existing under and by virtue of the laws of the United States, or any other bank or trust company which may at any time be substituted in its place as provided in the Indenture.

1998 Trustee

The term "1998 Trustee" means Wells Fargo Bank, National Association, as successor trustee under the 1998 Trust Agreement.

Underwriters

The term "Underwriters" means, collectively, Morgan Stanley & Co. Incorporated, J.P. Morgan Securities Inc., Estrada Hinojosa, Ramirez & Co., and Siebert Brandford Shank & Co., LLC.

Water System

The term "Water System" means any and all facilities, properties, improvements and works at any time owned, controlled or operated by the City as part of the public utility system of the City for water purposes, for the development, obtaining, conservation, production, storage, treatment, transmission, furnishing and distribution of water and its other commodities or byproducts for public and private use (whether located within or outside the City), and any related or incidental operations designated by the City as part of the Water System, including reclaimed and re-purified water.

Written Request of the Authority

The term "Written Request of the Authority" means an instrument in writing signed by the Chair, the Vice Chair, or the Secretary of the Authority, or by any other officer or Commissioner of the Board duly authorized by the Authority for that purpose.

Written Request of the City

The term "Written Request of the City" means an instrument in writing signed by the *Chief Operating Officer, the Chief Financial Officer or any of their respective designees*, or by any other official of the applicable administrative departments of the City duly authorized by the City for that purpose.

Establishment of Funds; Deposit and Application

Establishment of Funds and Accounts.

(a) The Authority shall cause the City to establish and maintain a special trust fund to be held by the Treasurer designated the "City of San Diego Water System Improvement Project Acquisition Fund – 2009A Bonds" (the "Acquisition Fund"), within which the Treasurer shall establish the Costs of Issuance Account.

(b) The Trustee shall establish and maintain the Payment Fund, including the Interest Account, the Principal Account, and the Redemption Account.

(c) [The Trustee shall also establish and maintain the Reserve Fund, and within the Reserve Fund, the 2009A Reserve Account.]

Use of Moneys in Acquisition Fund. The Acquisition Fund shall initially be unfunded, except for a deposit to pay Costs of Issuance The Treasurer shall hold moneys in the Costs of Issuance Account within the Acquisition Fund and the Comptroller shall disburse moneys therefrom to pay Costs of Issuance with respect to the 2009A Bonds. Such disbursements shall be made from time to time upon receipt of Requisitions of the City on behalf of the Authority substantially in the form attached hereto as Exhibit B.

[Reserve Fund. The Reserve Fund is to be a separate fund held in trust by the Trustee. The Trustee shall receive for deposit into the Reserve Fund [the Surety Bond] [$________] in satisfaction of the 2009A Reserve Requirement. An amount equal to the Reserve Requirement shall be maintained in or credited to the Reserve Fund at all times, subject to the provisions of the Indenture, and any deficiency therein shall be replenished from the first available Revenues pursuant to the Indenture.]

(a) [Moneys in or available from the Reserve Fund shall be used solely for the purpose of paying the principal of and interest on the Bonds, including the redemption price of the Bonds coming due and payable by operation of mandatory sinking fund redemption pursuant to the Indenture, in the event that the moneys in the Payment Fund are insufficient therefor. While the Surety Bond is in effect, not less than two Business Days prior to each Interest Payment Date, the Trustee shall ascertain the necessity for a draw upon the Surety Bond and, if a draw is necessary, shall provide notice thereof to the provider of the Surety Bond in accordance with the terms of the Surety Bond at least two Business Days prior to each Interest Payment Date. In the event that the amount on deposit in the Payment Fund on any date is insufficient to enable the Trustee to pay in full the aggregate amount of principal of and interest on the Bonds coming due and payable, including the redemption price of the Bonds coming due and payable by operation of mandatory sinking fund redemption pursuant to the Indenture, the Trustee shall withdraw the amount of such insufficiency from the Reserve Fund or make a draw upon the Surety Bond in the amount of such insufficiency and transfer such amount to the Payment Fund.]

(b) [In the event that the amount on deposit in the Reserve Fund exceeds the Reserve Requirement on the fifteenth (15th) calendar day of the month preceding any Interest Payment Date, the amount of such excess shall be withdrawn therefrom by the Trustee and transferred to (a) the Rebate Fund, to the extent required under the Indenture, or (b) the Payment Fund.]

(c) [The Authority may replace all or a portion of the Reserve Requirement, if originally funded with cash, with one or more Surety Bonds. Upon deposit of any Surety Bond with the Trustee, the Trustee shall transfer to the Acquisition Fund from amounts in the Reserve Fund an amount equal to the principal of the Surety Bond, which principal shall comprise the Reserve Requirement hereunder, or make other transfers in accordance with a Written Direction of the City.]

[In any case where the Reserve Fund is funded with a combination of cash and a Surety Bond, the Trustee shall deplete all cash balances before drawing on the Surety Bond. With regard to replenishment, any available moneys provided by the City shall be used first to reinstate the Surety Bond and second, to replenish the cash in the Reserve Fund in accordance with subsection (e) of the Indenture. In the event the Surety Bond is drawn upon, the City shall make payment of interest on amounts advanced under the Surety Bond after making any payments pursuant to the Indenture.]

[In the event the Surety Bond is scheduled to lapse or expire, the Trustee shall draw upon such Surety Bond prior to its lapsing or expiring in the full amount of such Surety Bond, make deposits from available Revenues to the Reserve Fund to increase the amount on deposit therein to the Reserve Requirement or substitute such Surety Bond with a Surety Bond that satisfies the requirements of the Indenture.]

[In no event shall the City or the Authority be required to replace any Surety Bond initially delivered hereunder with a similar instrument or with cash.]

(d) [In the event that the amount on deposit in the Reserve Fund at any time falls below the Reserve Requirement or in the event of a draw on the Surety Bond deposited therein, the Trustee shall promptly notify the City and the Authority of such fact and the Trustee shall promptly (A)(i) withdraw the amount of such insufficiency from available Revenues on deposit in the Payment Fund, and (ii) transfer such amount to the Reserve Fund or (B)(i) withdraw an amount necessary to repay such drawing on the Surety Bond and related expenses. Repayment of draws, expenses and accrued interest (collectively, "Policy Costs") shall commence in the first month following each draw, and each such monthly payment shall be in an amount at least equal to 1/12 of the aggregate of Policy Costs related to such draw. No deposit need be made in the Reserve Fund so long as the balance therein, taken together with amounts available under any Surety Bond, at least equals the Reserve Requirement. Upon receipt of written notice from the Trustee of a shortfall in the Reserve Fund, the City shall promptly transfer to the Trustee from Net System Revenues an amount sufficient to restore the balance on deposit in or credited to the Reserve Fund to the Reserve Requirement and to repay any amounts then due to the provider of the Surety Bond, if any.]

Revenues

Pledge of Revenues.

(a) All Revenues and amounts on deposit in the funds and accounts established under the Indenture (other than amounts on deposit in the Rebate Fund) are irrevocably pledged to the payment of the interest on and principal of the Bonds, but only as provided in the Indenture, and the Revenues shall not be used for any other purpose while any of the Bonds remain Outstanding; provided, that out of the Revenues there may be allocated such sums for such purposes as are expressly permitted by the Indenture.

(b) To secure the pledge of the Revenues contained in the Indenture, the Authority transfers, conveys and assigns to the Trustee, for the benefit of the Owners, all of the Authority's rights under the 2009A Supplement, including the right to receive Installment Payments from the City, the right to receive any proceeds of insurance maintained thereunder or any condemnation award rendered with respect to the Refunded Components and the right to exercise any remedies provided therein in the event of a default by the City thereunder. The Trustee hereby accepts said assignment for the benefit of the Owners subject to the provisions of the Indenture.

(c) The Trustee shall be entitled to and shall receive all of the 2009A Installment Payments, and any 2009A Installment Payments collected or received by the Authority shall be deemed to be held, and to have been collected or received, by the Authority as agent of the Trustee and shall forthwith be paid by the Authority to the Trustee.

Receipt and Deposit of Revenues in the Payment Fund. To carry out and effectuate the pledge contained herein, the Authority agrees and covenants that all Revenues when and as received shall be received in trust hereunder for the benefit of the Owners and shall be deposited when and as received in the Payment Fund. All Revenues shall be accounted for through and held in trust in the Payment Fund, and the Authority shall have no beneficial right or interest in any of the Revenues except only as herein provided. All Revenues, whether received by the Authority in trust or deposited with the Trustee as herein provided, shall nevertheless be allocated, applied and disbursed solely to the purposes and uses hereinafter set forth in the

Indenture, and shall be accounted for separately and apart from all other accounts, funds, money or other assets of the Authority.

Maintenance of Accounts for Use of Money in the Payment Fund.

(a) All money in the Payment Fund shall be deposited by the Trustee in the following respective special accounts within the Payment Fund in the following order of priority:

(i) Interest Account,

(ii) Principal Account, and

(iii) Redemption Account.

All money in each of such Accounts shall be held in trust by the Trustee and shall be applied, used and withdrawn only for the purposes authorized in the Indenture.

(b) On or before each Interest Payment Date, the Trustee shall transfer from the Payment Fund and deposit in the Interest Account that amount of money that, together with any money contained in the Interest Account, equals the aggregate amount of interest becoming due and payable on all Outstanding Bonds on such Interest Payment Date. No deposit need be made in the Interest Account if the amount contained in the Interest Account equals at least the aggregate amount of interest becoming due and payable on all Outstanding Bonds on such Interest Payment Date. All money in the Interest Account shall be used and withdrawn by the Trustee solely for the purpose of paying the interest on the Bonds as it shall become due and payable (including accrued interest on any Bonds redeemed prior to maturity).

(c) On or before each Principal Payment Date, the Trustee shall transfer from the Payment Fund and deposit in the Principal Account that amount of money that, together with any money contained in the Principal Account, equals the aggregate principal becoming due and payable on all Outstanding Bonds. No deposit need be made in the Principal Account if the amount contained therein is at least equal to the aggregate amount of principal become due and payable on all Outstanding Bonds. All money in the Principal Account shall be used and withdrawn by the Trustee solely for the purpose of paying the principal of the Bonds as it shall become due and payable.

(d) All money in the Redemption Account shall be held in trust by the Trustee and shall be applied, used, and withdrawn either to redeem the Bonds pursuant to the Indenture. Any moneys that, pursuant to the Agreement and the related provisions of any Supplements, are to be used to redeem Bonds shall be deposited by the Trustee in the Redemption Account. The Trustee shall, on the scheduled redemption date, withdraw from the Redemption Account and pay to the Owners entitled thereto an amount equal to the redemption price of the Bonds to be redeemed on such date.

(e) Any delinquent Installment Payments pledged to the Bonds shall be applied first to the Interest Account for the immediate payment of interest payments past due and then to the Principal Account for immediate payment of principal payments past due on any

Bond. Any remaining money representing delinquent Installment Payments pledged to Bonds shall be deposited in the Payment Fund to be applied in the manner provided therein.

Investment of Moneys in Funds and Accounts. Moneys in the Acquisition Fund shall be accounted for by the Comptroller and invested by the Treasurer in any legally permitted investment, including but not limited to the pooled investment fund of the City. In the absence of a Written Request of the City, the Trustee may invest moneys in the funds and accounts held by the Trustee in Permitted Investments described in clause (8) of the definition thereof. The obligations in which moneys in the said funds and accounts are invested shall mature prior to the date on which such moneys are estimated to be required to be paid out hereunder. For purposes of determining the amount of deposit in any fund or account, all investments credited to such fund or account shall be valued at the lesser of market value or the cost thereof. The Trustee shall semiannually, on or before January 15 and July 15 of each year, and at such times as the Authority shall deem appropriate, value the investments in the funds and accounts hereunder on the basis of the lesser of market value or the cost thereof. Except as otherwise provided in the Indenture, Permitted Investments representing an investment of moneys attributable to any fund or account hereunder and all investment profits or losses thereon shall be deemed at all times to be a part of said fund or account.

Additional Bonds

Execution and Delivery of Additional Bonds. In addition to the 2009A Bonds, the Trustee shall, upon Written Request of the Authority, by a supplement to the Indenture, establish one or more other series of Bonds secured by the pledge made under the Indenture equally and ratably with any Bonds previously issued and delivered, in such principal amount as shall be determined by the Authority, but only upon compliance with the provisions of the Indenture, the requirements of the Agreement applicable to the incurrence of Parity or Subordinated Obligations, as applicable, and any additional requirements set forth in the applicable Supplemental Indenture, which are hereby made conditions precedent to the execution and delivery of Additional Bonds:

(a) No Event of Default shall have occurred and be then continuing;

(b) The Supplemental Indenture providing for the execution and delivery of such Additional Bonds shall specify the purposes for which such Additional Bonds are then proposed to be delivered, which shall be one or more of the following: (i) to provide moneys needed to provide for Project Costs by depositing into the Acquisition Fund the proceeds of such Additional Bonds to be so applied; (ii) to provide for the payment or redemption of Bonds then Outstanding hereunder, by depositing with the Trustee moneys and/or investments required for such purpose under the defeasance provisions set forth in the Indenture; or (iii) to provide moneys needed to refund or refinance all or part of any other current or future obligations of the City with respect to the funding of the Water System. Such Supplemental Indenture may, but shall not be required to, provide for the payment of expenses incidental to such purposes, including the Costs of Issuance of such Additional Bonds, capitalized interest with respect thereto for any period authorized under the Code (in the case of Tax-Exempt Bonds) and, in the case of any Additional Bonds intended to provide for the payment or redemption of existing

Bonds, or other Obligations of the City, expenses incident to calling, redeeming, paying or otherwise discharging the Obligations to be paid with the proceeds of the Additional Bonds;

(c) The Authority shall deliver or cause to be delivered to the Trustee, from the proceeds of such Additional Bonds or from any other lawfully available source of moneys, an amount (or a Surety Bond in an amount) sufficient to increase the balance in the Reserve Fund to the Reserve Fund Requirement for all Bonds and Additional Bonds to be then Outstanding;

(d) The Additional Bonds shall be payable as to principal on August 1 and as to interest on February 1 and August 1 of each year during their term, except that the first interest payment due with respect thereto may be for a period of not longer than twelve (12) months;

(e) Fixed serial maturities or mandatory sinking account payments, or any combination thereof, shall be established in amounts sufficient to provide for the retirement of all of the Additional Bonds of such Series on or before their respective maturity dates;

(f) The aggregate principal amount of Bonds and Additional Bonds executed and delivered hereunder shall not exceed any limitation imposed by law or by any Supplemental Indenture; and

(g) The Trustee shall be the Trustee for the Additional Bonds.

Nothing in the Indenture shall limit in any way the power and authority of the Authority to incur other obligations payable from other lawful sources.

Proceedings for Execution and Delivery of Additional Bonds. Whenever the Authority shall determine to file its Written Request with the Trustee for the execution and delivery of Additional Bonds, the Authority shall authorize the execution and delivery of a Supplemental Indenture, specifying the aggregate principal amount and describing the forms of Bonds and providing the terms, conditions, distinctive designation, denominations, date, maturity date or dates, interest rate or rates (or the manner of determining same), Interest Payments and payment dates, redemption provisions and place or places of payment of principal or redemption price, if any, and interest represented by such Additional Bonds not inconsistent with the terms of the Indenture.

Before any series of Additional Bonds may be executed and delivered by the Trustee, the Authority shall file the following documents with the Trustee:

(a) An executed copy of the applicable Supplemental Indenture;

(b) A statement of the Authority to the effect that the requirements hereof have been met;

(c) In the case of a Series of Additional Bonds delivered for the purpose described in the Indenture, irrevocable instructions to the Trustee to give notice as provided in the Indenture of redemption of all Bonds to be redeemed in connection therewith; and

(d) An opinion or opinions of Bond Counsel, to the effect that the execution and delivery of the Additional Bonds, the supplement to the Indenture and related supplements or amendments have been duly authorized by the Authority and meet the requirements of the Indenture; and that the execution and delivery of such Additional Bonds will not, in and of themselves, cause the interest on the Tax-Exempt Bonds to become included within the gross income for purposes of federal income taxation.

Covenants of Authority

Punctual Payment and Performance. The Authority shall punctually pay the interest and the principal to become due on every Bond issued hereunder in strict conformity with the terms of the Indenture and of the Bonds, and shall faithfully observe and perform all the agreements and covenants contained therein.

Rebate Fund.

(a) The Trustee shall maintain such accounts within the Rebate Fund as it is instructed by the Authority as shall be necessary in order to comply with the applicable Tax Certificate (which is incorporated herein by reference). The Trustee shall deposit moneys in the Rebate Fund made available by the Authority and/or the City pursuant to a Written Request of the City. All money at any time deposited in the Rebate Fund shall be governed by the Indenture and the Tax Certificate and shall be held by the Trustee in trust, to the extent required to satisfy the amount required to be rebated to the United States under the Code, and none of the City, the Corporation, Authority, the Trustee nor the Owners shall have any rights in or claims to such money. The Trustee shall make information regarding the investments hereunder available to the City, shall invest the Rebate Fund in Permitted Investments pursuant to a Written Request of the City that is in conformity with the restrictions set forth in the Tax Certificate and shall deposit income from such Permitted Investments immediately upon receipt thereof into the Rebate Fund. The Trustee agrees to comply with all Written Requests of the City given in accordance with the Tax Certificate.

(b) The City and the Authority shall make or cause to be made the rebate computations respecting all Outstanding Bonds in accordance with the Tax Certificate, as required by the Code, and shall provide to the Trustee written evidence that the computation of the rebate requirement has been made along with a letter from an independent certified public accountant or arbitrage consultant verifying the accuracy of such calculations. Upon a Written Request of the City, the Trustee shall make deposits into the Rebate Fund from deposits by the City so that the balance of the amount on deposit shall be equal to the rebate requirement. The Trustee shall have no obligation to rebate any amounts required to be rebated pursuant to the Indenture, other than from moneys held in the Rebate Fund or from other moneys provided to it by the City on behalf of itself or the Authority.

(c) Not later than sixty (60) days after the end of the fifth Bond Year as defined in the Tax Certificate and every five (5) years thereafter, the Trustee, upon receipt of a Written Request of the City, shall pay to the United States part or all of the amounts in the Rebate Fund, as so directed. Each payment shall be accompanied by a statement summarizing the determination of the amount to be paid to the United States, as provided by the City. In addition, if the City so directs, then the Trustee shall deposit moneys into or transfer moneys out of the Rebate Fund from or into such accounts or funds as directed by the Written Request of the City. Any amounts remaining in the Rebate Fund following the final payment of the rebate requirement shall be paid to the City. Money, including investment earnings, shall not be transferred from the Rebate Fund except as provided in the Indenture.

(d) Notwithstanding any other provision the Indenture, the obligation to remit the rebate requirement to the United States and to comply with all other requirements of the Indenture and the Tax Certificate shall survive the defeasance or payment in full of the Tax-Exempt Bonds.

(e) The Authority shall not use or permit any proceeds of the Tax-Exempt Bonds or any funds of the Authority, directly or indirectly, to acquire any securities or obligations, and shall not take or permit to be taken any other action or actions, that would cause any Tax-Exempt Bonds to be an "arbitrage bond" within the meaning of the Code or "federally guaranteed" within the meaning of Section 149(b) of the Code and any applicable regulations promulgated from time to time thereunder and under Section 103(c) of the Code. The Authority shall observe and not violate the requirements of Section 148 of the Code and any such applicable regulations. The Authority shall comply with all requirements of Sections 148 and 149(b) of the Code to the extent applicable to the Tax-Exempt Bonds.

(f) The Authority specifically covenants to comply with the provisions and procedures of the Tax Certificate.

(g) The Authority shall not use or permit the use of any proceeds of the Bonds or any funds of the Authority, directly or indirectly, in any manner, and shall not take or omit to take any action that would cause any Tax-Exempt Bonds to be treated as an obligation not described in Section 103(a) of the Code.

(h) Notwithstanding any provisions of the Indenture, if the Authority and the City shall provide to the Trustee an opinion of Bond Counsel to the effect that any specified action required under the Indenture is no longer required or that some further or different action is required to maintain the exclusion from gross income for federal income tax purposes of interest with respect to the Tax-Exempt Bonds, the Trustee, the Authority and the City may conclusively rely on such opinion in complying with the requirements of the Indenture and the covenants hereunder shall be deemed to be modified to that extent.

Accounting Records and Reports. The Authority shall keep or cause to be kept proper books of record and accounts in which complete and correct entries shall be made of all transactions relating to the receipts, disbursements, allocation and application of the Revenues, and such books shall be available for inspection by the Trustee, at reasonable hours and under reasonable conditions. Not more than 270 days after the close of each Fiscal Year, the Authority shall furnish or cause to be furnished to the Trustee financial statements that include the Water Utility Fund for the preceding Fiscal Year, prepared in accordance with generally accepted accounting principles, together with a report of an Independent Certified Public Accountant thereon. For purposes of the Indenture, "financial statement" shall mean audited financial statements, if available, or unaudited financial statements, if audited financial statements are not available and unaudited financial statements are available. The Authority shall also keep or cause to be kept such other information as is required under the Tax Certificate.

The City's Budgets. The Authority shall supply to the Trustee, as soon as practicable after the beginning of each Fiscal Year following the effectiveness of the applicable City ordinance but in no event later than six months from the date of effectiveness of such ordinance, a Certificate of the City certifying that the City has made adequate provision in its annual budget for such Fiscal Year for the payment of all Parity Installment Payments, Subordinated Installment Payments and all other Obligations due under the 2009A Supplement and the Agreement in such Fiscal Year. If the amounts so budgeted are not adequate for the payment of all Parity Installment Payments, Subordinated Installment Payments and all other Obligations due under the Agreement in such Fiscal Year, the Authority shall take such action as may be necessary and within its power to request such annual budget to be amended, corrected or augmented by the City so as to include therein the amounts required to be paid by the City from Net System Revenues in such Fiscal Year, and shall notify the Trustee of the proceedings then taken or proposed to be by the Authority.

Continuing Disclosure. The City has undertaken all responsibility for compliance with continuing disclosure requirements, and accordingly the Authority shall have no liability to the Owners of the Bonds or any other person with respect to S.E.C. Rule 15c2-12, and the City shall comply with and carry out all of the provisions of each continuing disclosure certificate, each dated the date of the execution and delivery of each Series of Bonds. *See* the caption in this Official Statement, "CONTINUING DISCLOSURE." Notwithstanding any other provision the Indenture, failure of the City to comply with a Continuing Disclosure Certificate shall not be considered an Event of Default hereunder or under the Installment Purchase Agreement; provided, that the Trustee may and, at the request of any participating underwriter or the Owners of at least twenty-five percent (25%) in aggregate principal amount of the Outstanding Bonds of any series, shall, or any Owner or Beneficial Owner of any of the Bonds may, take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the City to comply with its obligations under the related Continuing Disclosure Certificate.

Amendment of Indenture

Amendment of Indenture.

(a) The Indenture and the rights and obligations of the Authority and of the all Owners of the Bonds may be amended at any time by a Supplemental Indenture, which shall become binding when the written consents of the Owners of 51% in aggregate principal amount of the Bonds then Outstanding, exclusive of Bonds disqualified as provided in the Indenture, are filed with the Trustee. No such amendment shall (i) permit the creation by the Authority of any pledge of the Revenues as provided herein superior to or on a parity with the pledge created hereby for the benefit of any Bond without the written consent of the Owner thereof; (ii) modify any rights or obligations of the Trustee without its prior written assent thereto; or (iii) modify provisions respecting the time or amount of payments on any Bond, without the written consent of the Owner thereof.

(b) The Indenture and the rights and obligations of the Authority and of the Owners may also be amended at any time by a Supplemental Indenture which shall become binding without the consent of any Owners of Bonds for any one or more of the following purposes:

(i) to make such provisions for the purpose of curing any ambiguity or of correcting, curing or supplementing any defective provision contained herein in regard to questions arising hereunder that the Authority may deem desirable or necessary and not inconsistent herewith and that shall not adversely affect the interests of the Owners; or

(ii) to make any other change or addition thereto that shall not materially adversely affect the interests of the Owners, or to surrender any right or power reserved herein to or conferred herein on the Authority; provided, however, that the Owners shall be given prompt notice of any such amendment and shall receive a copy of the final executed Supplemental Indenture making such changes.

Disqualified Subordinated Bonds. Bonds owned or held by or for the account of the Authority or the City shall not be deemed Outstanding for the purpose of any consent or other action or any calculation of Outstanding Bonds provided in the Indenture, and shall not be entitled to consent to or take any other action provided therein.

Endorsement or Replacement of Bonds After Amendment. After the effective date of any action taken as described hereinabove, the Authority may determine that the Bonds may bear a notation by endorsement in form approved by the Authority as to such action, and in that case upon demand of the Owner of any Outstanding Bond and presentation of its Bond for such purpose at the Corporate Trust Office of the Trustee, a suitable notation as to such action shall be made on such Bond. If the Authority shall determine that a Bond shall bear such a notation by endorsement pursuant to the Indenture, a new Bond so modified shall be prepared and executed, and upon demand of the Owner of any Outstanding Bond, such new Bond shall be exchanged at the Corporate Trust Office of the Trustee without cost to such Owner upon surrender of such Bond.

Amendment by Mutual Consent. The provisions of the Indenture shall not prevent any Owner from accepting any amendment as to the particular Bonds owned by him, provided that due notation thereof is made on such Bonds.

Events of Default and Remedies of Holders

Events of Default and Acceleration of Maturities.

(a) The following events shall constitute events of default under the Indenture:

(i) failure in the due and punctual payment of the interest on the Bonds when and as the same shall become due and payable;

(ii) failure in the due and punctual payment of the principal of the Bonds when and as the same shall become due and payable, whether at maturity as therein expressed or by proceedings for redemption;

(iii) failure by the Authority in the performance of any of the other agreements or covenants required in the Indenture to be performed by the Authority, as set forth in the Indenture, and such default shall have continued for a period of 30 days after the Authority and the City shall have been given notice in writing of such default by the Trustee or to the Authority, the City and the Trustee by Owners of 25% or more of the aggregate principal amount of the Bonds then Outstanding; or

(iv) if any event of default shall have occurred and be continuing under Section 8.01 of the Agreement; or

(v) if the Authority shall file a petition or answer seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or if under the provisions of any other law for the relief or aid of debtors any court of competent jurisdiction shall assume custody or control of the Authority or of the whole or any substantial part of its property.

(b) If one or more Events of Default shall occur, then and in each and every such case during the continuance of such Event of Default, the Trustee may by notice in writing to the Authority and the City, declare the principal of all Bonds then Outstanding and the interest accrued thereon to be due and payable immediately. Upon any such declaration, the same shall become due and payable, anything contained in the Indenture or in the Bonds to the contrary notwithstanding. These provisions are subject to the condition that if at any time after the entire principal amount of the unpaid Bonds and the accrued interest thereon shall have been so declared due and payable and before any judgment or decree for the payment of the moneys due shall have been obtained or entered, there shall be deposited with the Trustee a sum sufficient to pay the unpaid principal amount of the Bonds due prior to such declaration and the accrued interest thereon, with interest on such overdue installments at the rate or rates applicable thereto in accordance with their terms, and the reasonable fees and expenses of the Trustee, and any and all other defaults known to the Trustee (other than in the payment the entire principal amount of the unpaid Bonds and the accrued interest thereon due and payable solely by reason of such declaration) shall have been made good or cured to the satisfaction of the Trustee or provision deemed by the Trustee to be adequate shall have been made therefor, then and in every such case the Trustee, by written notice to the City and the Authority, may rescind and annul such declaration and its consequences; but no such rescission and annulment shall extend to or shall affect any subsequent default or shall impair or exhaust any right or power consequent thereon.

Proceedings by Trustee. Upon the occurrence and continuance of any Event of Default, the Trustee in its discretion may, and at the written request of Owners of 51% or more in aggregate principal amount of Bonds Outstanding shall (but only to the extent indemnified to its satisfaction from fees and expenses, including attorneys' fees), do the following:

(a) by mandamus, or other suit, action or proceeding at law or in equity, enforce all rights of the Owners and require the Authority to enforce all rights of the Owners of the Bonds, including the right to require the Authority to receive and collect Revenues and to enforce its rights under the Agreement and to require the Authority to carry out any other covenant or agreement with Owners of Bonds and to perform its duties hereunder;

(b) bring suit upon the Bonds;

(c) by action or suit in equity enjoin any acts or things that may be unlawful or in violation of the rights of the Owners; and

(d) as a matter of right, have receivers appointed for the Revenues and the issues, earnings, income, products and profits thereof, pending such proceedings, with such powers as the court making such appointment shall confer.

Effect of Discontinuance or Abandonment. In case any proceeding taken by the Trustee on account of any default or Event of Default shall have been discontinued or abandoned for any reason, or shall have been determined adversely to the Trustee, then and in every such case, the Authority, the Trustee and the Owners shall be restored to their former positions and rights under the Indenture, respectively, and all rights, remedies and powers of the Trustee shall continue as though no such proceeding had been taken.

Rights of Owners.

(a) Anything in the Indenture to the contrary notwithstanding and subject to the limitations and restrictions as to the rights of the Owners in the Indenture, upon the occurrence and continuance of any Event of Default or the Owners of 51% or more in aggregate principal amount of the Bonds then Outstanding shall have the right upon providing the Trustee security and indemnity reasonably satisfactory to it against the costs, expenses, and liabilities to be incurred therein or thereby, by an instrument in writing executed and delivered to the Trustee, to direct the method and place of conducting all remedial proceedings to be taken by the Trustee under the Indenture.

(b) The Trustee may refuse to follow any direction that conflicts with law or the Indenture or that the Trustee determines is prejudicial to rights of other Owners or would subject the Trustee to personal liability.

Restrictions on Owners' Actions.

(a) In addition to the other restrictions on the rights of Owners to request action upon the occurrence of an Event of Default and to enforce remedies set forth in the Indenture, no Owner of any of the Bonds shall have any right to institute any suit, action or proceeding in equity or at law for the enforcement of any trust under the Indenture, or any other remedy under the Indenture or on said Bonds, unless:

(i) such Owner previously shall have given to the Trustee written notice of an Event of Default as provided in the Indenture; and

(ii) the Owners of 51% or more in aggregate principal amount of the Bonds then Outstanding shall have made written request of the Trustee to institute any such suit, action, proceeding or other remedy, after the right to exercise such powers or rights of action, as the case may be, shall have accrued, and shall have afforded the Trustee a reasonable opportunity either to proceed to exercise the powers granted in the Indenture, or to institute such action, suit or proceeding in its or their name; and

(iii) there shall have been offered to the Trustee security and indemnity satisfactory to it against the costs, expenses and liabilities to be incurred therein or thereby; and

(iv) the Trustee shall not have complied with such request within a reasonable time.

(b) Such notification, request and offer of indemnity are hereby declared in every such case, at the option of the Trustee, to be conditions precedent to the execution of the trusts of the Indenture or for any other remedy under the Indenture. It is understood and intended, subject to the Indenture, that no one or more Owners of the Bonds shall have any right in any manner whatever by his or their action to affect, disturb or prejudice the security of the Indenture, or to enforce any right under the Indenture or under the Bonds, except in the manner therein provided, and that all proceedings at law or in equity shall be instituted, and maintained in the manner therein provided, and for the equal benefit of all Owners of Outstanding Bonds.

Power of Trustee to Enforce. All rights of action under the Indenture or under any of the Bonds secured by the Indenture which are enforceable by the Trustee may be enforced by it without the possession of any of the Bonds, or the production thereof at the trial or other proceedings relative thereto. Any such suit, action or proceedings instituted by the Trustee shall be brought in its own name, as Trustee, for the equal and ratable benefit of the Owners of the Bonds, subject to the provisions of the Indenture.

Remedies Not Exclusive. No remedy in the Indenture conferred upon or reserved to the Trustee or to the Owners of the Bonds is intended to be exclusive of any other remedy or remedies, and each and every such remedy shall be cumulative, and shall be in addition to every other remedy given under the Indenture or now or hereafter existing at law or in equity or by statute.

Waiver of Events of Default; Effect of Waiver.

(a) The Trustee shall waive any Event of Default under the Indenture and its consequences and rescind any declaration of acceleration, upon the written request of the Owners of 67% or more of the Outstanding Bonds. If any Event of Default shall have been waived as provided in the Indenture, the Trustee shall promptly give written notice of such waiver to the Authority and shall give notice thereof by first class mail, postage prepaid to all Owners of Outstanding Bonds if such Owners had previously been given notices of such Event of Default. No such waiver, rescission and annulment shall extend to or affect any subsequent Event of Default, or impair any right or remedy consequent thereon.

(b) No delay or omission of the Trustee or any Owner of the Bonds to exercise any right or power accruing upon any default or Event of Default shall impair any such right or power or shall be construed to be a waiver of any such default or Event of Default or an acquiescence therein. Every power and remedy given by the Indenture to the Trustee or the

Owners of the Bonds, respectively, may be exercised from time to time and as often as may be deemed expedient.

Application of Moneys.

(a) Any moneys received by the Trustee pursuant to the Indenture, together with any moneys that upon the occurrence of an Event of Default are held by the Trustee in any of the funds and accounts hereunder (other than the Rebate Fund and other than moneys held for Bonds not presented for payment) shall, after payment of all fees and expenses of the Trustee, and the fees and expenses of its counsel, be applied as follows:

(i) Unless the principal of all of the Outstanding Bonds shall be due and payable:

(i) – To the payment of the Owners of all installments of interest then due on the Bonds, in the order of the maturity of the installments of such interest and, if the amount available shall not be sufficient to pay in full any particular installment, then to the payment ratably, according to the amounts due on such installment, to the Owners, without any discrimination or privilege;

(ii) – To the payment of the Owners of the unpaid principal of any of the Bonds that shall have become due (other than Bonds matured or called for redemption for the payment of which moneys are held pursuant to the provisions of the Indenture), in the order of their due dates and, if the amount available shall not be sufficient to pay in full the principal of and premium, if any, on such Bonds due on any particular date, then to the payment ratably, according to the amount due on such date, to the Owners without any discrimination; and

(iii) – To be held for the payment to the Owners as the same shall become due of the principal of and interest on the Bonds, that may thereafter become due either at maturity or upon call for redemption prior to maturity and, if the amount available shall not be sufficient to pay in full such principal and premium, if any, due on any particular date, together with interest then due and owing thereon, payment shall be made in accordance with the Indenture.

(ii) If the principal of all of the Outstanding Bonds shall be due and payable, to the payment of the principal and interest then due and unpaid upon the Outstanding Bonds without preference or priority of any of principal, or interest over the others or of any installment of interest, or of any Outstanding Bond over any other Outstanding Bond, ratably, according to the amounts due respectively for principal and interest, to the Owners without any discrimination or preference except as to any difference in the respective amounts of interest specified in the Outstanding Bonds.

(b) Whenever moneys are to be applied pursuant to the provisions of the Indenture, such moneys shall be applied at such times, and from time to time, as the Trustee shall determine, having due regard to the amount of such moneys available for application and the likelihood of additional moneys becoming available for such application in the future. The

Trustee shall give, by mailing by first-class mail as it may deem appropriate, such notice of the *deposit with it of any such moneys.*

Defeasance

If the Authority shall pay or cause to be paid to the Owners of all Outstanding Bonds the interest thereon and the principal thereof and the premiums, if any, thereon at the times and in the manner stipulated therein, then the Owners of such Bonds shall cease to be entitled to the pledge of the Revenues as provided herein, and all agreements, covenants and other obligations of the Authority to the Owners of such Bonds shall cease, terminate and become void and be discharged and satisfied. In such event, the Trustee shall execute and deliver to the Authority all such instruments as may be necessary or desirable to evidence such discharge and satisfaction, and the Trustee shall pay over or deliver to the Authority all money or securities or other property held by it pursuant hereto that are not required for the payment of the interest on and principal of and redemption premiums, if any, on such Bonds.

Subject to the provisions of the above paragraph, when any of the Bonds shall have been paid and if, at the time of such payment, the Authority shall have kept, performed and observed all the covenants and promises in such Bonds and in the Indenture required or contemplated to be kept, performed and observed by the Authority or on its part on or prior to that time, then the Indenture shall be considered to have been discharged in respect of such Bonds and such Bonds shall cease to be entitled to the lien of the Indenture and such lien and all agreements, covenants, and other obligations of the Authority therein shall cease, terminate and become void and be discharged and satisfied as to such Bonds.

Notwithstanding the satisfaction and discharge of the Indenture or the discharge of the Indenture in respect of any Bonds, those provisions of the Indenture relating to the maturity of the Bonds, interest payments and dates thereof, exchange and transfer of Bonds, replacement of mutilated, destroyed, lost or stolen Bonds, the safekeeping and cancellation of Bonds, nonpresentment of Bonds, and the duties of the Trustee in connection with all of the foregoing, remain in effect and shall be binding upon the Trustee and the Owners of the Bonds and the Trustee shall continue to be obligated to hold in trust any moneys or investments then held by the Trustee for the payment of the principal of, redemption premium, if any, and interest on the Bonds, to pay to the Owners of Bonds the funds so held by the Trustee as and when such payment becomes due. Notwithstanding the satisfaction and discharge of the Indenture or the discharge thereof in respect of any Bonds, those provisions of the Indenture relating to the compensation of the Trustee shall remain in effect and shall be binding upon the Trustee and the Authority.

Any Outstanding Bonds shall prior to the maturity date or redemption date thereof be deemed to have been paid for purposes of the Indenture if: (i) in case any of such Bonds are to be redeemed on any date prior to their maturity date, the Authority shall have given to the Trustee in form satisfactory to it irrevocable instructions to mail, on a date in accordance with the provisions of the Indenture, notice of redemption of such Bonds on said redemption date, said notice to be given in accordance with the Indenture; (ii) there shall have been deposited with the Trustee either (A) money in an amount which shall be sufficient; or (B) Federal Securities of which are not subject to redemption prior to maturity except by the holder thereof (including any such Permitted Investments issued or held in book-entry form on the books of the Department of the Treasury of the United States of America) and/or Pre-Refunded Municipals, the interest on and principal of which when due, and without any reinvestment thereof, will provide money that, together with the money, if any, deposited with the Trustee at the same time, shall, as verified by an independent certified public accountant or other independent financial consultant acceptable to the Trustee, be sufficient, to pay when due the interest to become due on such Bonds on and prior to the maturity date or redemption date thereof, as the case may be, and the principal of and interest on such Bonds; and; (iii) in the event such Bonds are not by their terms subject to redemption within the next succeeding 60 days, the Authority shall have given the Trustee in form satisfactory to it irrevocable instructions to mail as soon as practicable, a notice to the Owners of such Bonds and to the Securities Depositories and the Information Services that the deposit required by clause (ii) above has been made with the Trustee and that such Bonds are deemed to have been paid in accordance with the Indenture and stating the maturity date or redemption date upon which money is to be available for the payment of the principal of and interest on such Bonds.

INSTALLMENT PURCHASE AGREEMENT

The Installment Purchase Agreement (herein, the "Agreement") sets forth certain terms and conditions of the purchase of the Project by the City. Certain definitions under and provisions of the Installation Purchase Agreement are given and summarized below. Other provisions are summarized in the Official Statement under the caption "SECURITY FOR THE SERIES 2009A BONDS."

Accountant's Report

The term "Accountant's Report" means a report signed by an Independent Certified Public Accountant.

Adjusted Debt Service

The term "Adjusted Debt Service" means, for any Fiscal Year, Debt Service on Parity Obligations for such Fiscal Year, minus an amount equal to earnings from investments in any Reserve Fund securing Parity Obligations for such Fiscal Year.

Adjusted Net System Revenues

The term "Adjusted Net System Revenues" means, for any Fiscal Year, the Net System Revenues for such Fiscal Year, minus an amount equal to earnings from investments in any Reserve Fund securing Parity Obligations for such Fiscal Year.

Authorizing Ordinance

The term "Authorizing Ordinance" means the ordinance pursuant to which the Installment Purchase Agreement was authorized and any additional ordinance or official authorizing act of the council of the City approving execution and delivery of any Supplement to the Agreement or any Issuing Instrument.

Balloon Indebtedness

The term "Balloon Indebtedness" means, with respect to any Series of Obligations twenty-five percent (25%) or more of the principal of which matures on the same date or within a 12-month period (with sinking fund payments on Term Obligations deemed to be payments of matured principal), that portion of such Series of Obligations which matures on such date or within such 12-month period; provided, however, that to constitute Balloon Indebtedness the amount of indebtedness maturing on a single date or over a 12-month period must equal or exceed 150% of the amount of such Series of Obligations which matures during any preceding 12-month period. For purposes of this definition, the principal amount maturing on any date shall be reduced by the amount of such indebtedness which is required, by the documents governing such indebtedness, to be amortized by prepayment or redemption prior to its stated maturity date.

Capacity Charge

The term "Capacity Charge" means a charge imposed upon a person, firm, corporation or other entity incident to the granting of a permit for a new water connection or due to an increase in water usage by the addition of any type of dwelling, commercial or industrial unit, which charge is based upon an increase in water consumption as measured by equivalent dwelling units, and the proceeds of which are used to construct, improve and expand the Water System to accommodate the additional business of such added dwellings or commercial or industrial units.

Consultant

The term "Consultant" means the consultant, consulting firm, engineer, architect, engineering firm, architectural firm, accountant or accounting firm retained by the City to perform acts or carry out the duties provided for such consultant in the Agreement. Such consultant, consulting firm, engineer, architect, engineering firm or architectural firm shall be nationally recognized within its profession for work of the character required. Such accountants or accounting firm shall be independent certified public accountants licensed to practice in the State.

Credit Provider

The term "Credit Provider" means any municipal bond insurance company, bank or other financial institution or organization which is performing in all material respects its obligations under any Credit Support Instrument for some or all of the Parity Obligations.

Credit Provider Reimbursement Obligations

The term "Credit Provider Reimbursement Obligations" means obligations of the City to repay, from Net System Revenues, amounts advanced by a Credit Provider as credit support or liquidity for Parity Obligations, which obligations shall constitute Parity Obligations or Subordinated Obligations, as designated by the City.

Credit Support Instrument

The term "Credit Support Instrument" means a policy of insurance, a letter of credit, a standby purchase agreement, revolving credit agreement or other credit arrangement pursuant to which a Credit Provider provides credit support or liquidity with respect to the payment of interest, principal or the purchase price of any Parity Obligations.

Debt Service

With regard to the issuance of Parity Obligations, the term "Debt Service" means, for any Fiscal Year, the sum of (a) the interest payable during such Fiscal Year on all Outstanding Parity Obligations, assuming that all Outstanding Serial Parity Obligations are retired as scheduled and that all Outstanding Term Parity Obligations are redeemed or paid from sinking fund payments as scheduled (except to the extent that such interest is to be paid from the proceeds of sale of any Parity Obligations), (b) that portion of the principal amount of all Outstanding Serial Parity Obligations maturing on the next succeeding principal payment date which falls in such Fiscal Year (excluding Serial Obligations which at the time of issuance are intended to be paid from the sale of a corresponding amount of Parity Obligations), (c) that portion of the principal amount of all Outstanding Term Parity Obligations required to be redeemed or paid on any redemption date which falls in such Fiscal Year (together with the redemption premiums, if any, thereon); provided that, (1) as to any Balloon Indebtedness, Tender Indebtedness and Variable Rate Indebtedness, interest thereon shall be calculated as provided in the definition of Maximum Annual Debt Service and principal shall be deemed due at the nominal maturity dates thereof; (2) the amount on deposit in a debt service reserve fund on any date of calculation of Debt Service shall be deducted from the amount of principal due at the final maturity of the Parity Obligations for which such debt service reserve fund was established and in each preceding year until such amount is exhausted; (3) the amount of any interest payable on any Parity Obligation for which there exists a Qualified Swap Agreement shall be the net amount payable by the City as provided in subsection A(viii)(1) or (2), B(viii)(1) or (2), as applicable, of the definition of Maximum Annual Debt Service; and (4) the amount of payments on account of Parity Obligations which are redeemed, retired or repaid on the basis of the accreted value due on the scheduled redemption, retirement or repayment date shall be deemed principal payments, and interest that is compounded and paid as part of the accreted value shall be deemed payable on the scheduled redemption, retirement or repayment date, but not before.

With regard to the issuance of Subordinated Obligations, the term "Debt Service" means, for any Fiscal Year, the sum of (a) the interest payable during such Fiscal Year on all Outstanding Obligations, assuming that all Outstanding Serial Obligations are retired as scheduled and that all Outstanding Term Obligations are redeemed or paid from sinking fund payments as scheduled (except to the extent that such interest is to be paid from the proceeds of sale of any Obligations), (b) that portion of the principal amount of all Outstanding Serial Obligations maturing on the next succeeding principal payment date which falls in such Fiscal Year (excluding Serial Obligations which at the time of issuance are intended to be paid from the sale of a corresponding amount of other Obligations) (c) that portion of the principal amount of all Outstanding Term Obligations required to be redeemed or paid on any redemption date which falls in such Fiscal Year (together with the redemption premiums, if any, thereon) provided that, (1) as to any Balloon Indebtedness, Tender Indebtedness and Variable Rate Indebtedness, interest thereon shall be calculated as provided in the definition of Maximum Annual Debt Service and principal shall be deemed due at the nominal maturity dates thereof; (2) the amount on deposit in a Reserve Fund on any date of calculation of Debt Service shall be deducted from the amount of principal due at the final maturity of the Obligations for which such Reserve Fund was established and in each preceding year, until such amount is exhausted; (3) the amount of any interest payable on any Obligations for which there exists a Qualified Swap Agreement shall be the net amount payable by the City as provided in paragraph A(viii)(1) or (2) or paragraph B(viii)(1) or (2), as applicable, of the definition of Maximum Annual Debt Service; and (4) the amount of payments on account of Obligations which are redeemed, retired or repaid on the basis of the accreted value due on the scheduled redemption, retirement or repayment date shall be deemed principal payments, and interest that is compounded and paid as part of the accreted value thereof shall be deemed payable on the scheduled redemption, retirement or repayment date, but not before.

Default Rate

The term "Default Rate" means the Maximum Rate.

Defaulted Obligations

The term "Defaulted Obligations" means Obligations in respect of which an Event of Default has occurred and is continuing.

Engineer's Report

The term "Engineer's Report" means a report signed by an Independent Engineer.

Event of Default

The term "Event of Default" means any occurrence or event described as in the Agreement, as further described below.

Feasibility Report

The term "Feasibility Report" means a report of a Consultant with special expertise on the construction and operation of water systems similar to the Water System, delivered in connection with the incurrence of Additional Obligations.

Fiscal Year

The term "Fiscal Year" means the period beginning on July 1 of each year and ending on the next succeeding June 30, or any other twelve-month period selected and designated as the official Fiscal Year of the City.

Independent Certified Public Accountant

The term "Independent Certified Public Accountant" means any firm of certified public accountants appointed by the City, and each of whom is independent pursuant to the Statement on Auditing Standards No. 1 of the American Institute of Certified Public Accountants.

Independent Engineer

The term "Independent Engineer" means any registered engineer or firm of registered engineers of national reputation generally recognized to be well qualified in engineering matters relating to water systems, appointed and paid by but not under the control of the City.

Installment Payment Date

The term "Installment Payment Date" means any date on which an Installment Payment is due as specified in the Agreement or determined pursuant to a Supplement.

Installment Payments

The term "Installment Payments" means the Installment Payments scheduled to be paid by the City under and pursuant to the Agreement and any Supplement.

Installment Payment Obligations

The term "Installment Payment Obligations" means Obligations consisting of or which are supported in whole by Installment Payments.

Issuing Instrument

The term "Issuing Instrument" shall mean any indenture, trust agreement, loan agreement, lease, installment purchase agreement or the Agreement, including any Supplement or other instrument under which Obligations are issued or created.

Law

The term "Law" means the Charter and all applicable laws of the State.

Maintenance and Operation Costs of the Water System

The term "Maintenance and Operation Costs of the Water System" means (a) any Qualified Take or Pay Obligation, and (b) the reasonable and necessary costs spent or incurred by the City for maintaining and operating the Water System, calculated in accordance with generally accepted accounting principles, including, without limitation, the costs of the purchase, delivery or storage of water, the reasonable expenses of maintenance and repair and other expenses necessary to maintain and preserve the Water System in good repair and working order, and including administrative costs of the City attributable to the Water System, including the Project and the Installment Purchase Agreement, salaries and wages of employees of the Water System, payments to such employees' retirement systems (to the extent paid from System

Revenues), overhead, taxes (if any), fees of auditors, accountants, attorneys or engineers and insurance premiums, and including all other reasonable and necessary costs of the City or charges required to be paid by it to comply with the terms of the Obligations, including the Installment Purchase Agreement, including any amounts required to be deposited in the Rebate Fund pursuant to a Tax Certificate, and fees and expenses payable to any Credit Provider (other than in repayment of a Credit Provider Reimbursement Obligation), but excluding in all cases (1) depreciation, replacement and obsolescence charges or reserves therefor, (2) amortization of intangibles or other bookkeeping entries of a similar nature, (3) costs of capital additions, replacements, betterments, extensions or improvements to the Water System which under generally accepted accounting principles are chargeable to a capital account or to a reserve for depreciation, (4) charges for the payment of principal of and interest on any general obligation bond issued for Water System purposes, (5) charges for the payment of principal of and interest on any debt service on account of any Obligation on a parity with or subordinate to the Installment Payments, and (6) all payments made pursuant to any Qualified Swap Agreement.

Maximum Annual Debt Service

The term "Maximum Annual Debt Service" means,

(A) with respect to Parity Obligations then Outstanding, the maximum amount of principal and interest becoming due on the Parity Obligations in the then-current or any future Fiscal Year, calculated by the City or by an Independent Certified Public Accountant in accordance with the Installment Purchase Agreement and provided to the Trustee. For purposes of calculating Maximum Annual Debt Service, the following assumptions shall be used to calculate the principal and interest becoming due in any Fiscal Year:

(i) in determining the principal amount due in each Fiscal Year, payments shall (except to the extent a different subsection of this definition applies for purposes of determining principal maturities or amortization) be assumed to be made in accordance with any amortization schedule established for such debt, including the amount of any Parity Obligations which are or have the characteristics of commercial paper and which are not intended at the time of issuance to be retired from the sale of a corresponding amount of Parity Obligations, and including any scheduled mandatory redemption or prepayment of Parity Obligations on the basis of accreted value due upon such redemption or prepayment, and for such purpose, the redemption payment or prepayment shall be deemed a principal payment; provided, however, that with respect to Parity Obligations which are or have the characteristics of commercial paper and which are intended at the time of issuance to be retired from the sale of a corresponding amount of other Obligations, which other Obligations would not constitute Balloon Indebtedness, each maturity thereof shall be treated as if it were to be amortized in substantially equal installments of principal and interest over a term of 30 years, commencing in the year of such stated maturity; in determining the interest due in each Fiscal Year, interest payable at a fixed rate shall (except to the extent paragraph (A)(ii) or (iii) of this definition applies) be assumed to be made at such fixed rate and on the required payment dates;

(ii) if all or any portion or portions of an Outstanding Series of Parity Obligations constitute Balloon Indebtedness or if all or any portion or portions of a Series of Parity Obligations or such payments then proposed to be issued would constitute Balloon Indebtedness, then, for purposes of determining Maximum Annual Debt Service, each maturity which constitutes Balloon Indebtedness shall be treated as if it were to be amortized in substantially equal annual installments of principal and interest over a term of 30 years, commencing in the year the stated maturity of such Balloon Indebtedness occurs, the interest rate used for such computation shall be determined as provided in paragraph (A)(iv) or (v) below, as appropriate, and all payments of principal and interest becoming due prior to the year of the stated maturity of the Balloon Indebtedness shall be treated as described in paragraph (A)(i) above;

(iii) if any Outstanding Series of Parity Obligations constitutes Tender Indebtedness or if Parity Obligations proposed to be issued would constitute Tender Indebtedness, then for purposes of determining Maximum Annual Debt Service, Tender Indebtedness shall be treated as if the principal amount of such Parity Obligations were to be amortized in accordance with the amortization schedule set forth in the Supplement or Issuing Instrument for such Tender Indebtedness or in the standby purchase or liquidity facility established with respect to such Tender Indebtedness, or if no such amortization schedule is set forth, then such Tender Indebtedness shall be deemed to be amortized in substantially equal annual installments of principal and interest over a term of 30 years commencing in the year in which such Series is first subject to tender, the interest rate used for such computation shall be determined as provided in paragraph (A)(iv) or (v) below, as appropriate;

(iv) if any Outstanding Series of Parity Obligations constitutes Variable Rate Indebtedness, the interest rate on such Obligations shall be assumed to be 110% of the daily average interest rate on such Parity Obligations during the 12 months ending with the month preceding the date of calculation, or such shorter period that such Parity Obligations shall have been Outstanding; provided that in the event that such Variable Rate Indebtedness has been issued in connection with a Qualified Swap Agreement, the interest rate for purposes of computing Maximum Annual Debt Service shall be determined by (1) calculating the annualized net amount paid by the City under such Variable Rate Indebtedness and Qualified Swap Agreement (after giving effect to payments made under the Variable Rate Indebtedness and made and received by the City under the Qualified Swap Agreement) during the 12 months ending with the month preceding the date of calculation, or such shorter period that such Qualified Swap Agreement has been in effect, and (2) dividing the amount calculated in clause (1) by the average daily balance of the related Parity Obligations Outstanding during the 12-month period contemplated by clause (1);

(v) if Parity Obligations proposed to be issued will be Variable Rate Indebtedness, then such Parity Obligations shall be assumed to bear interest at 80% of the average Revenue Bond Index during the calendar quarter preceding the calendar quarter in which the calculation is made, or if that index is no longer published, another similar index selected by the City, or if the City fails to select a replacement index, an interest rate equal to 80% of the yield for outstanding United States Treasury bonds having an equivalent maturity, or if there are no such Treasury bonds having such maturities, 100% of the lowest prevailing prime rate of any of the five largest commercial banks in the United States ranked by assets; provided that in the event that such Variable Rate Indebtedness will be issued in connection with a Qualified Swap Agreement, the interest rate for purposes of computing Maximum Annual Debt Service shall be determined by (1) calculating the net amount to be paid by the City under such Variable Rate Indebtedness and Qualified Swap Agreement after giving effect to payments to be made under the Variable Rate

Indebtedness and to be made and received by the City under the Qualified Swap Agreement) for the period during which the Qualified Swap Agreement is to be in effect and for this purpose, any variable rate of interest agreed to be paid thereunder shall be deemed to be the rate at which the related Parity Obligation shall be assumed to bear interest, and (2) dividing the amount calculated in clause (1) by the average principal amount of the related Parity Obligation to be Outstanding during the first Fiscal Year after the issuance of such Parity Obligation;

(vi) if moneys or Permitted Investments have been deposited by the City into a separate fund or account or are otherwise held by the City or by a fiduciary to be used to pay principal of and/or interest on specified Parity Obligations, then the principal and/or interest to be paid from such moneys, Permitted Investments or from the earnings thereon shall be disregarded and not included in calculating Maximum Annual Debt Service;

(vii) if Parity Obligations are Paired Obligations, the interest thereon shall be the resulting linked rate or effective fixed rate to be paid with respect to such Paired Obligations; and

(viii) in the event that an agreement or commitment which, at the time of calculation, is a Qualified Swap Agreement is or is to be in effect with respect to a Parity Obligation which is not Variable Rate Indebtedness, the interest rate of such Parity Obligation for purposes of calculating Maximum Annual Debt Service shall be calculated as follows:

(1) for such a Qualified Swap Agreement which is in effect on the date of calculation, the interest rate shall be calculated in the same manner as is specified in clause (iv) above for a Qualified Swap Agreement issued in connection with Variable Rate Indebtedness which is Outstanding on the date of calculation; and

(2) for such a Qualified Swap Agreement which is not in effect on the date of calculation, the interest rate shall be calculated in the same manner as is specified in clause (v) above for a Qualified Swap Agreement to be issued in connection with Variable Rate Indebtedness to be Outstanding after the date of calculation, and for this purpose, any variable rate of interest agreed to be paid thereunder shall be assumed to be the rate assumed for Variable Rate Indebtedness described in clause (v) above.

(B) with regard to all Obligations then Outstanding, the maximum amount of principal and interest becoming due on the Obligations in the then-current or any future Fiscal Year, calculated by the City or by an Independent Certified Public Accountant in accordance with this subsection and provided to the Trustee. For purposes of calculating Maximum Annual Debt Service, the following assumptions shall be used to calculate the principal and interest becoming due in any Fiscal Year:

(i) in determining the principal amount due in each Fiscal Year, payments shall (except to the extent a different subsection of this definition applies for purposes of determining principal maturities or amortization) be assumed to be made in accordance with any amortization schedule established for such debt, including the amount of any Obligations which are or have the characteristics of commercial paper and which are not intended at the time of issuance to be retired from the sale of a corresponding amount of Obligations, and including any scheduled mandatory redemption or prepayment of Obligations on the basis of accreted value due upon such redemption or prepayment, and for such purpose, the redemption payment or prepayment shall be deemed a principal payment; provided, however, that with respect to Obligations which are or have the characteristics of commercial paper and which are intended at the time of issuance to be retired from the proceeds of sale of a corresponding amount of other Obligations, and which would not constitute Balloon Indebtedness, each maturity thereof shall be treated as if it were to be amortized in substantially equal installments of principal and interest over a term of 30 years, commencing in the year of such stated maturity; in determining the interest due in each Fiscal Year, interest payable at a fixed rate shall (except to the extent paragraph (B)(ii) or (iii) of this definition applies) be assumed to be made at such fixed rate and on the required payment dates;

(ii) if all or any portion or portions of an Outstanding Series of Obligations constitute Balloon Indebtedness or if all or any portion or portions of a Series of Obligations or such payments then proposed to be issued would constitute Balloon Indebtedness, then, for purposes of determining Maximum Annual Debt Service, each maturity which constitutes Balloon Indebtedness shall be treated as if it were to be amortized in substantially equal annual installments of principal and interest over a term of 30 years, commencing in the year the stated maturity of such Balloon Indebtedness occurs, the interest rate used for such computation shall be determined as provided in paragraph (B)(iv) or (v) below, as appropriate, and all payments of principal and interest becoming due prior to the year of the stated maturity of the Balloon Indebtedness shall be treated as described in paragraph (B)(i) above;

(iii) if any Outstanding Series of Obligations constitutes Tender Indebtedness or if Obligations proposed to be issued would constitute Tender Indebtedness, then for purposes of determining Maximum Annual Debt Service, Tender Indebtedness shall be treated as if the principal amount of such Obligations were to be amortized in accordance with the amortization schedule set forth in the Supplement or Issuing Instrument for such Tender Indebtedness or in the standby purchase or liquidity facility established with respect to such Tender Indebtedness, or if no such amortization schedule is set forth, then such Tender Indebtedness shall be deemed to be amortized in substantially equal annual installments of principal and interest over a term of 30 years, commencing in the year in which such Obligations are first subject to tender, the interest rate used for such computation shall be determined as provided in paragraph (B)(iv) or (v) below, as appropriate;

(iv) if any Outstanding Series of Obligations constitute Variable Rate Indebtedness, the interest rate on such Series of Obligations shall be assumed to be 110% of the daily average interest rate on such Series of Obligations during the 12 months ending with the month preceding the date of calculation, or such shorter period that such Series of Obligations shall have been Outstanding; provided, that in the event that such Variable Rate Indebtedness has been issued in connection with a Qualified Swap Agreement, the interest rate for purposes of computing Maximum Annual Debt Service shall be determined by (1) calculating the annualized net amount paid by the City under such Variable Rate Indebtedness and Qualified Swap Agreement (after giving effect to payments made under the Variable Rate Indebtedness and made and received by the City under the Qualified Swap Agreement) during the 12 months ending with the month preceding the date of calculation, or such shorter period that such Qualified Swap Agreement has been in effect, and (2) dividing the amount calculated in clause (1) by the average daily balance of the related Obligations Outstanding during the 12-month period contemplated by clause (1);

(v) if Obligations proposed to be issued will be Variable Rate Indebtedness, then such Obligations shall be assumed to bear interest at 80% of the average Revenue Bond Index during the calendar quarter preceding the calendar quarter in which the calculation is made, or if that index is no longer published, another similar index selected by the City, or if the City fails to select a replacement index, an interest rate equal to 80% of the yield for outstanding United States Treasury bonds having an equivalent maturity, or if there are no such Treasury bonds having such maturities, 100% of the lowest prevailing prime rate of any of the five largest commercial banks in the United States ranked by assets, provided, that if such Variable Rate Indebtedness will be issued in connection with a Qualified Swap Agreement, the interest rate for purposes of computing Maximum Annual Debt Service shall be determined by (1) calculating the net amount to be paid by the City under such Variable Rate Indebtedness and Qualified Swap Agreement (after giving effect to payments to be made under the Variable Rate Indebtedness and to be made and received by the City under the Qualified Swap Agreement) for the period during which the Qualified Swap Agreement is to be in effect and for this purpose, any variable rate of interest agreed to be paid thereunder shall be deemed to be the rate at which the related Obligations shall be assumed to bear interest, and (2) dividing the amount calculated in clause (1) by the average principal amount of the related Obligations to be Outstanding during the first Fiscal Year after the issuance of such Obligations;

(vi) if moneys or Permitted Investments have been deposited by the City into a separate fund or account or are otherwise held by the City or by a fiduciary to be used to pay principal and/or interest on specified Obligations, then the principal and/or interest to be paid from such moneys, Permitted Investments or from the earnings thereon shall be disregarded and not included in calculating Maximum Annual Debt Service;

(vii) if Obligations are Paired Obligations, the interest thereon shall be the resulting linked rate or effective fixed rate to be paid with respect to such Paired Obligations; and

(viii) in the event that an agreement or commitment which, at the time of calculation, is a Qualified Swap Agreement is or is to be in effect with respect to an Obligation which is not Variable Rate Indebtedness, the interest rate of such Obligation for purposes of calculating Maximum Annual Debt Service shall be calculated as follows:

(1) for such a Qualified Swap Agreement which is in effect on the date of calculation, the interest rate shall be calculated in the same manner as is specified in clause (iv) above for a Qualified Swap Agreement issued in connection with Variable Rate Indebtedness which is Outstanding on the date of calculation; and

(2) for such a Qualified Swap Agreement which is not in effect on the date of calculation, the interest rate shall be calculated in the same manner as is specified in clause (v) above for a Qualified Swap Agreement to be issued in connection with Variable Rate Indebtedness to be Outstanding after the date of calculation, and for this purpose, any variable rate of interest agreed to be paid thereunder shall be assumed to be the rate assumed for Variable Rate Indebtedness described in clause (v) above.

Maximum Rate

The term "Maximum Rate" means, on any day, the maximum interest rate allowed by law.

Net Proceeds

The term "Net Proceeds" means, when used with respect to any insurance, self-insurance or condemnation award, the proceeds from such award that are remaining after payment of all expenses (including attorneys' fees) incurred in the collection of such proceeds.

Net System Revenues

The term "Net System Revenues" means, for any Fiscal Year, the System Revenues for such Fiscal Year, less the Maintenance and Operation Costs of the Water System for such Fiscal Year.

Obligations

The term "Obligations" means (a) obligations of the City for money borrowed (such as bonds, notes or other evidences of indebtedness) or as installment purchase payments under any contract (including Installment Payments), or as lease payments under any financing lease (determined to be such in accordance with generally accepted accounting principles), the principal of and interest on which are payable from Net System Revenues; (b) obligations to replenish any debt service reserve funds with respect to such obligations of the City; (c) obligations secured by or payable from any of such obligations of the City; and (d) obligations of the City payable from Net System Revenues under (1) any contract providing for payments based on levels of, or changes in, interest rates, currency exchange rates, stock or other indices, (2) any contract to exchange cash flows or a series of payments, or (3) any contract to hedge payment, currency, rate spread or similar exposure, including but not limited to interest rate swap agreements and interest rate cap agreements.

Outstanding

The term "Outstanding," when used as of any particular time with respect to Obligations, means all Obligations theretofore or thereupon executed, authenticated and delivered by the City or any trustee or other fiduciary, *except* (a) Obligations theretofore cancelled or surrendered for cancellation; (b) Obligations paid or deemed to be paid within the meaning of any defeasance provisions thereof; (c) Obligations owned by the City; and (d) Obligations in lieu of or in substitution for which other Obligations have been executed and delivered.

Owner

The term "Owner" means any person who shall be the registered owner of any certificate or other evidence of a right to receive Installment Payments directly or as security for payment of an Outstanding Obligation.

Paired Obligations

The term "Paired Obligations" shall mean any Series (or portion thereof) of Parity Obligations designated as Paired Obligations in a Supplement or related Issuing Instrument or other document authorizing the issuance or incurrence thereof, which are simultaneously issued or incurred, (a) the principal and notional amount of each of which is of equal amount maturing and to be prepaid or redeemed (or cancelled after acquisition thereof) on the same dates and in the same amounts, and (b) the interest rates for which, taken together, result in an irrevocably fixed interest rate obligation of the City for the term of such Paired Obligations.

As to Subordinated Obligations, the term "Paired Obligations," as used in the definitions of "Maximum Annual Debt Service" and "Variable Rate Indebtedness," means any Series (or portion thereof) of Subordinated Obligations which are simultaneously issued or incurred, (a) the principal and notional amount of each of which is of equal amount maturing and to be prepaid or redeemed (or cancelled after acquisition thereof) on the same dates and in the same amounts, and (b) the interest rates for which, taken together, result in an irrevocably fixed interest rate obligation of the City for the term of such Obligations.

Parity Installment Obligation

The term "Parity Installment Obligation" means Obligations consisting of or payable from Installment Payments which are not subordinated in right of payment to other Installment Payments.

Parity Obligations

The term "Parity Obligations" means (a) Parity Installment Obligations, (b) Obligations, the principal of and interest on which are payable on a parity with Parity Installment Obligations, (c) Reserve Fund Obligations, and (d) payments due under Qualified Swap Agreements that do not constitute termination or unwinding payments.

Payment Fund

The term "Payment Fund" means the fund designated in the Issuing Instrument as the fund into which Installment Payments are to be deposited for the purposes of paying principal of or interest on related Obligations.

Permitted Investments

The term "Permitted Investments" means investments which pursuant to an Issuing Instrument are permissible for the investment of funds received from the sale of Obligations pursuant to the Issuing Document or from other funds held pursuant to the Issuing Document.

Project; 1998 Project

The term "Project" means the construction, replacement and improvements to the Water System described in Exhibit A thereto, as it may be modified from time to time in conformance with the Installment Purchase Agreement. The term "1998 Project" means the Components of the Project initially financed under the Agreement.

Purchase Price

The term "Purchase Price" means the principal amount, plus interest thereon, owed by the City to the Corporation under the terms hereof for the purchase of Project Components, as specified in the Agreement or in a Supplement.

Qualified Swap Agreement

The term "Qualified Swap Agreement" means a contract or agreement, payable from Net System Revenues on a parity with the related Series of Obligations, intended to place such Obligations on the interest rate, currency, cash flow or other basis desired by the City, including, without limitation, any interest rate swap agreement, currency swap agreement, forward payment conversion agreement or futures contract, any contract providing for payments based on levels of, or changes in, interest rates, currency exchange rates, stock or other indices, any contract to exchange cash flows or a series of payments, or any contract, including, without limitation, an interest rate floor or cap, or an option, put or call, to hedge payment, currency, rate, spread or similar exposure, between the City and a counterparty; provided that not less than 30 days prior to the City's execution of a Qualified Swap Agreement, each Rating Agency which then maintains a rating with respect to any Parity Obligation, if the Qualified Swap Agreement relates to Parity Obligations, or with respect to any Subordinated Obligations, if the Qualified Swap Agreement relates to Subordinated Obligations, receives notice in writing of the City's pending execution thereof.

Qualified Take or Pay Obligation

The term "Qualified Take or Pay Obligation" means the obligation of the City to make use of any facility, property or services, or some portion of the capacity thereof, or to pay therefor from System Revenues, or both, whether or not such facilities, properties or services are ever made available to the City for use, and there is provided to the City a certificate of the City or of an Independent Engineer to the effect that the incurrence of such obligation will not adversely affect the ability of the City to comply with the provisions of the Installment Purchase Agreement.

Rate Stabilization Fund

The term "Rate Stabilization Fund" means the fund by that name established pursuant to the Agreement.

Rebate Requirement

The term "Rebate Requirement" shall have the meaning specified in any Tax Certificate.

Reserve Fund

The term "Reserve Fund" shall refer to the fund by that name established under in an Issuing Instrument or Supplement.

Reserve Fund Obligations

The term "Reserve Fund Obligations" means the obligations of the City to pay amounts advanced under any Reserve Fund Credit Facility entered into in accordance with the provisions of the related Issuing Instrument or Supplement, which obligations shall constitute Parity Obligations or Subordinated Obligations, as designated by the City.

Reserve Fund Credit Facility

The term "Reserve Fund Credit Facility" shall mean a letter of credit, line of credit, surety bond, insurance policy or similar facility deposited in the Reserve Fund established under an Issuing Instrument in lieu of or in partial substitution for cash or securities on deposit therein.

Reserve Requirement

The term "Reserve Requirement" shall have the meaning given to such term in any Issuing Instrument or Supplement.

Revenue Bond Index

The term "Revenue Bond Index" means the Revenue Bond Index by that name published from time to time in *The Bond Buyer*.

Secondary Purchase Fund

The term "Secondary Purchase Fund" means any fund by that name established pursuant to the Agreement.

Serial Obligations

The term "Serial Obligations" means Obligations for which no sinking fund payments are provided.

Serial Parity Obligations

The term "Serial Parity Obligations" means Serial Obligations which are Parity Installment Payments or are payable on a parity with Parity Installment Obligations.

Series

The term "Series" means Obligations issued at the same time or sharing some other common term or characteristic and designated as a separate Series.

Subordinated Credit Provider

The term "Subordinated Credit Provider" means any municipal bond insurance company, bank or other financial institution or organization which is performing in all respects its obligations under any Subordinated Credit Support Instrument for some or all of the Subordinated Obligations.

Subordinated Credit Provider Reimbursement Obligations

The term "Subordinated Credit Provider Reimbursement Obligations" means obligations of the City to repay, from Net System Revenues, amounts advanced by a Subordinated Credit Provider as credit support or liquidity for Subordinated Obligations, which obligations shall constitute Subordinated Obligations.

Subordinated Credit Support Instrument

The term "Subordinated Credit Support Instrument" means a policy of insurance, a letter of credit, a standby purchase agreement, revolving credit agreement or other credit arrangement pursuant to which a Subordinated Credit Provider provides credit support or liquidity with respect to the payment of interest, principal or the purchase price of any Subordinated Obligations.

Subordinated Obligations

The term "Subordinated Obligations" means any Obligations, the payment of which is subordinated in right of payment to Parity Obligations.

System Revenues

The term "System Revenues" means all income, rents, rates, fees, charges and other moneys derived from the ownership or operation of the Water System, including, without limiting the generality of the foregoing:

(a) all income, rents, rates, fees, charges, or other moneys derived by the City from the water services or facilities, and commodities or byproducts, including hydroelectric power, sold, furnished or supplied through the facilities of or in the conduct or operation of the business of the Water System, and including, without limitation, investment earnings on the operating reserves to the extent that the use of such earnings is limited to the Water System by or pursuant to law, and earnings on any Reserve Fund for Obligations, but only to the extent that such earnings may be utilized under the Issuing Instrument for the payment of debt service for such Obligations;

(b) standby charges and Capacity Charges[*] derived from the services and facilities sold or supplied through the Water System;

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[*] These items of System Revenue may not be used to pay Maintenance and Operation Costs of the Water System.

(c) the proceeds derived by the City directly or indirectly from the lease of a part of the Water System;

(d) any amount received from the levy or collection of taxes which are solely available and are earmarked for the support of the operation of the Water System;

(e) amounts received under contracts or agreements with governmental or private entities and designated for capital costs for the Water System;[*] and

(f) grants for maintenance and operations received from the United States of America or from the State; provided, however, that System Revenues shall not include: (1) in all cases, customers' deposits or any other deposits or advances subject to refund until such deposits or advances have become the property of the City; and (2) the proceeds of borrowings; but

(g) notwithstanding the foregoing, there shall be deducted from System Revenues any amounts transferred into a Rate Stabilization Fund as contemplated by the Installment Purchase Agreement, and any amounts transferred from current System Revenues to the Secondary Purchase Fund as contemplated by the Installment Purchase Agreement, and there shall be added to System Revenues any amounts transferred out of such Rate Stabilization Fund or the Secondary Purchase Fund to pay Maintenance and Operation Costs of the Water System.

Tax-Exempt Installment Payment Obligations

The term "Tax-Exempt Installment Payment Obligations" means Installment Payment Obligations, the interest component of which is excluded from gross income pursuant to Section 103 of the Code.

Tender Indebtedness

The term "Tender Indebtedness" means any Obligations or portions of Obligations, a feature of which is an option, on the part of the holders thereof, or an obligation, under the terms of such Obligations, to tender all or a portion of such Obligations to the City, a Trustee or other fiduciary or agent for payment or purchase and requiring that such Obligations or portions of Obligations or that such rights to payments or portions of payments be purchased if properly presented. Tender Indebtedness may consist of either Parity Obligations or Subordinated Obligations.

Term Parity Obligations

The term "Term Parity Obligations" means Term Obligations which are Parity Installment Obligations or are payable on a parity with Parity Installment Obligations.

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[*] These items of System Revenue may not be used to pay Maintenance and Operation Costs of the Water System.

Term Obligations

The term "Term Obligations" means Obligations which are payable on or before their specified maturity dates from sinking fund payments established for that purpose and calculated to retire such Obligations on or before their specified maturity dates.

Variable Rate Indebtedness

The term "Variable Rate Indebtedness" means any portion of indebtedness evidenced by Obligations, the interest rate for which is subject to adjustment periodically through a remarketing process or according to a stated published index for similar obligations in the municipal markets, excluding Paired Obligations. Variable Rate Indebtedness may consist of either Parity Obligations or Subordinated Obligations.

Water Service

The term "Water Service" means the collection, conservation, production, storage, treatment, transmission, furnishing and distribution services made available or provided by the Water System.

Water Utility Fund

The term "Water Utility Fund" means the fund by that name established under the Charter.

Acquisition and Construction of the Project

Acquisition and Construction of the Project; Components. (a) The Corporation agrees to cause the Project to be constructed, acquired and installed by the City, as agent of the Corporation. The City shall enter into contracts and provide for, as agent of the Corporation, the complete construction, acquisition and installation of the Project. The City agrees that it will cause the construction, acquisition and installation of the Project to be diligently performed.

(a) It is expressly understood and agreed that, except to the extent of proceeds of Obligations which are deposited in an Acquisition Fund, the Corporation shall be under no liability of any kind or character whatsoever for the payment of any cost of any Components. In the event the proceeds of Obligations deposited in an Acquisition Fund are insufficient to complete the construction, acquisition and installation of the designated Components, the City shall cause to be deposited in such Acquisition Fund (or shall otherwise appropriate and encumber) from and to the extent of available amounts on deposit in the Water Utility Fund (or other lawfully available moneys) an amount equal to that necessary to complete the construction, acquisition and installation of such Components.

(b) The Corporation will not undertake to cause any Component of the Project to be constructed, acquired or installed unless and until the City and the Corporation have entered into a Supplement specifying the Components of the Project to be installed, the date of completion, the purchase price to be paid by the City hereunder for that Component of the Project, and the Installment Payments or the method of calculating Installment Payments.

Changes to the Project. (a) From time to time and at any time, subject to the restrictions set forth in paragraph (b) below, the City may modify or amend the description of the Project, to eliminate any part thereof and/or to add or substitute another Component or Components, all without obtaining any consent, by filing an amended Exhibit A with the Corporation and the Trustee under the related Issuing Instrument; provided however, that no such amendment shall add or substitute a Component or Components which are not to be accounted for as an asset of the Water Utility Fund or shall in any way impair the obligations of the City contained in any Supplement executed and delivered prior to any such amendment.

(b) The City may substitute other improvements for those listed as Components in any Supplement, but only if the City first files with the Corporation and the Trustee a certificate of an Authorized City Representative:

(i) identifying the Components to be substituted and the Components they replace;

(ii) stating that the substituted Components will be accounted for as an asset of the Water Utility Fund; and

(iii) stating that with respect to Components financed with Tax-Exempt Installment Payment Obligations, the estimated costs of construction, acquisition and installation of the substituted improvements are not less than such costs for the improvements previously included in such Supplement, that any excess amounts will be applied to the payment of principal evidenced by the related Obligations or any Additional Obligations, and that said substitution will not violate any provision of the related Tax Certificate.

(c) Substituted Components may include or consist of an undivided interest in such Components, in which event the costs associated with the substituted Components over and above the undivided interest need not be deposited in the Acquisition Fund (or otherwise appropriated and encumbered); provided, however, that the certificate of an Authorized City Representative specifies that the funds necessary to complete the substituted Components are on deposit in the Acquisition Fund or otherwise appropriated and encumbered.

Installment Payments

Purchase Price. (a) The City will pay the Purchase Price for any Components being purchased as provided in a Supplement. The Purchase Price to be paid by the City to the Corporation pursuant to any Supplement hereto, solely from Net System Revenues and from no other sources, is the sum of the principal amount of the City's obligations under such Supplement plus the interest to accrue on the unpaid balance of such principal amount from the effective date thereof over the term thereof, subject to prepayment as provided therein.

(b) The principal amount of the Installment Payments to be made by the City under a Supplement shall be paid at least three Business Days prior to the date such Installment Payments are payable as specified in such Supplement or at such other earlier time or times and in the manner or manners as specified in such Supplement. In the event the principal amount of an Installment Payment is not paid by the date the same is due and payable as specified in such

Supplement, the same shall bear interest at the Default Rate, commencing on the day the same as due, to, but not including, the payment date.

(c) The interest to accrue on the unpaid balance of such principal amount shall be paid at least three Business Days prior to the date such interest is payable as specified in a Supplement or at such other earlier time or times as specified in such Supplement, and shall be paid by the City as and constitute interest paid on the principal amount of the City's obligations thereunder. Interest shall be payable in an amount not exceeding the Maximum Rate at the time of incurring such obligation, at such intervals and according to such interest rate formulas as shall be specified in a Supplement or by reference to any Issuing Instrument to which such Supplement relates, and shall be payable with such frequency as shall be specified therein. In the event that interest is not paid by the date such interest is payable, to the extent permitted by applicable law, such interest shall thereafter bear interest at the Default Rate, commencing on the day the same is due, to, but not including, the payment date.

Installment Payments; Reserve Fund Payments. (a) The City shall, subject to any rights of prepayment provided for in a Supplement, pay to the Corporation, solely from Net System Revenues and from no other sources, the Purchase Price in Installment Payments over a period not to exceed the maximum period permitted by law, all as specified in a Supplement.

(b) In the event that a Trustee notifies the City that the amount on deposit in a Reserve Fund or Reserve Account is less than the Reserve Requirement, the City shall deposit or cause to be deposited, solely from Net System Revenues in accordance with the Agreement, in such Reserve Fund or Reserve Account such amounts on a monthly basis as are necessary to increase the amount on deposit therein to the Reserve Requirement in the ensuing twelve months.

(c) The obligation of the City to make the Installment Payments solely from Net System Revenues is absolute and unconditional, and until such time as the Purchase Price shall have been paid in full (or provision for the payment thereof shall have been made pursuant to the Agreement), the City will not discontinue or suspend any Installment Payments required to be made by it under the Agreement when due, whether or not the Project or any part thereof is operating or operable or has been completed, or its use is suspended, interfered with, reduced or curtailed or terminated in whole or in part, and such Installment Payments shall not be subject to reduction whether by offset or otherwise and shall not be conditioned upon the performance or nonperformance by any party of any agreement for any cause whatsoever.

System Revenues

Commitment of the Net System Revenues. (a) All Parity Obligations, including Parity Installment Payment Obligations, shall be secured by a first priority lien on and pledge of Net System Revenues. The City grants such first priority lien on and pledge of Net System Revenues to secure Parity Obligations. All Parity Obligations shall be of equal rank with each other without preference, priority or distinction of any Parity Obligations over any other Parity Obligations.

(b) All Subordinated Obligations shall be secured by a second priority lien on and pledge of Net System Revenues that is junior and subordinate to the lien on and pledge of Net System Revenues securing Parity Obligations. The City grants such second priority lien on and pledge of Net System Revenues to secure Subordinated Obligations. All Subordinated Obligations shall be of equal rank with each other without preference, priority or distinction of any Subordinated Obligations over any other Subordinated Obligations.

(c) The City represents and states that it has not granted any lien or charge on any of the Net System Revenues except as provided herein; provided, however, that out of Net System Revenues there may be apportioned such sums for such purposes as are expressly permitted by the Agreement.

(d) Nothing contained in the Installment Purchase Agreement shall affect the ability of the City to grant liens on and pledges of the Net System Revenues that are subordinate to the liens on and pledges of Net System Revenues for the benefit of Parity Obligations and Subordinated Obligations contained therein.

Allocation of System Revenues. (a) In order to carry out and effectuate the commitment and pledge contained in the Agreement, the City agrees and covenants that all System Revenues shall be received by the City in trust and shall be deposited when and as received in the Water Utility Fund, which fund the City agrees and covenants to maintain so long as any Installment Payment Obligations or payments due by the City under any Qualified Swap Agreement related thereto remain unpaid, and all moneys in the Water Utility Fund shall be so held in trust and applied and used solely as provided in the Installment Purchase Agreement. The City shall pay from the Water Utility Fund: (1) directly or as otherwise required all Maintenance and Operation Costs of the Water System; (2) to the Trustee, for deposit in the Payment Fund for Parity Obligations, including Reserve Fund Obligations that are Parity Obligations, the amounts specified in any Issuing Instrument, as payments due on account of Parity Obligations (including any Credit Provider Reimbursement Obligations that are Parity Obligations), other than payments due as Parity Obligations by the City under a Qualified Swap Agreement; and (3) to the counterparty specified in any Qualified Swap Agreement, the amounts or payments due under such Qualified Swap Agreement as Parity Obligations. In the event there are insufficient Net System Revenues to make all of the payments contemplated by clauses (2) and (3) of the immediately preceding sentence, then said payments should be made as nearly as practicable, *pro rata*, based upon the respective unpaid principal amounts of said Parity Obligations.

(b) After the payments contemplated by subsection (a) above have been made, and in any event not less frequently than January 15 and July 15 of each year, any remaining Net System Revenues shall be used to make up any deficiency in the Reserve Funds for Parity Obligations. Notwithstanding the use of a Reserve Fund Credit Facility in lieu of depositing funds in the related Reserve Fund for Parity Obligations, in the event of any draw on the related Reserve Fund Credit Facility, there shall be deemed a deficiency in such Reserve Fund for Parity Obligations until the amount of the Reserve Fund Credit Facility is restored to its pre-draw amount. In the event there are insufficient Net System Revenues to make up all deficiencies in all Reserve Funds for Parity Obligations, such payments into the Reserve Funds shall be made as nearly as practicable *pro rata* based on the respective unpaid principal amount of all Parity

Obligations. Any amounts thereafter remaining in the Water Utility Fund may from time to time be used to pay the amounts specified in any Issuing Instrument as payments due on account of Subordinated Obligations (including any Reserve Fund Obligations for Subordinated Obligations, any Credit Provider Reimbursement Obligations that are Subordinated Obligations and any Subordinated Credit Provider Reimbursement Obligations), provided the following conditions are met:

(i) all Maintenance and Operation Costs of the Water System are being and have been paid and are then current; and

(ii) all deposits and payments contemplated by clauses (2) and (3) of paragraph (a) above shall have been made in full and no deficiency in any Reserve Fund for Parity Obligations shall exist, and there shall have been paid, or segregated within the Water Utility Fund, the amounts payable during the current month pursuant to clauses (2) and (3) of paragraph (a) above.

After deposits contemplated above have been made, any amounts thereafter remaining in the Water Utility Fund may be used for any lawful purpose of the Water System.

Additional Obligations. (a) The City may not create any Obligations, the payments of which are senior or prior in right to the payment by the City of Parity Obligations.

(b) Without regard to paragraph (c) below, the City may at any time enter into or create an obligation or commitment which is a Reserve Fund Obligation or a Qualified Swap Agreement, provided that the Obligation to which the Reserve Fund Obligation or the Qualified Swap Agreement relates is permitted to be entered into under the terms of the Agreement.

(c) After the initial issuance of Parity Obligations under the Agreement, the City reserved the right, at any time and from time to time, to issue or create any other Parity Obligations, provided that:

(i) there shall not have occurred and be continuing (A) an Event of Default under the terms of the Installment Purchase Agreement, any Issuing Instrument or any Credit Support Instrument, or (B) an event of default or termination event (as defined in any Qualified Swap Agreement) attributable to an act or failure of the City under any Qualified Swap Agreement; and

(ii) the City obtains or provides a certificate or certificates, prepared by the City or at the City's option by a Consultant, showing that:

(A) the Net System Revenues as shown by the books of the City for any 12-consecutive-month period within the 18 consecutive months ending immediately prior to the incurring of such additional Parity Obligations shall have amounted to or exceeded the greater of (i) at least 1.20 times the Maximum Annual Debt Service on all Parity Obligations to be Outstanding immediately after the issuance of the proposed Parity Obligations or (ii) at least 1.00 times the Maximum Annual Debt Service on all Obligations to be Outstanding immediately after the issuance of the proposed Parity Obligations.

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For purposes of preparing the certificate or certificates described above, the City or its Consultant may rely upon audited financial statements, or, if audited financial statements for the period are not available, financial statements prepared by the City that have not been subject to audit by an Independent Certified Public Accountant; or

(B) the estimated Net System Revenues for the five Fiscal Years following the earlier of (i) the end of the period during which interest on those Parity Obligations is to be capitalized or, if no interest is to be capitalized, the Fiscal Year in which the Parity Obligations are issued, or (ii) the date on which substantially all new Components to be financed with such Parity Obligations are expected to commence operations, will be at least equal to 1.20 times the Maximum Annual Debt Service for all Parity Obligations which will be Outstanding immediately after the issuance of the proposed Parity Obligations.

(d) For purposes of the computations to be made as described in paragraph (c)(ii)(B) above, the determination of Net System Revenues:

(i) may take into account any increases in rates and charges which relate to the Water System and which have been approved by the City Council, and shall take into account any reduction in such rates and charges which have been approved by the City Council, which will, for purposes of the test described in paragraph (c)(ii)(B) above, be effective during a Fiscal Year ending within the five-Fiscal-Year period for which such estimate is being made; and

(ii) may take into account an allowance for any estimated increase in such Net System Revenues from any revenue-producing additions or improvements to or extensions of the Water System to be made with the proceeds of such additional indebtedness or with the proceeds of Parity Obligations previously issued, all in an amount equal to the estimated additional average annual Net System Revenues to be derived from such additions, improvements and extensions during the five-Fiscal-Year period contemplated by paragraph (c)(ii)(B) above, all as shown by such certificate of the City or its Consultant, as applicable; and

(iii) for the period contemplated by paragraph (c)(ii)(B), Maintenance and Operation Costs of the Water System shall initially be deemed to be equal to such costs for the 12 consecutive months immediately prior to incurring such other Parity Obligations for the first Fiscal Year of the five-Fiscal-Year period, but adjusted if deemed necessary by the City or its Consultant, as applicable, for any increased Maintenance and Operations Costs of the Water System which are, in the judgment of the City or such Consultant, as applicable, essential to maintaining and operating the Water System and which will occur during any Fiscal Year ending within the period contemplated by paragraph (c)(ii)(B) above.

(e) The certificate or certificates described above in paragraph (c)(ii)(B) shall not be required if the Parity Obligations being issued are for the purpose of (1) issuing the Parity Obligations initially issued under the Installment Purchase Agreement or (2) refunding (A) any then Outstanding Parity Obligations if at the time of the issuance of such Parity Obligations a certificate of an Authorized City Representative shall be delivered showing that the sum of Adjusted Debt Service on all Parity Obligations Outstanding for all remaining Fiscal Years after the issuance of the refunding Parity Obligations will not exceed the sum of Adjusted Debt Service on all Parity Obligations Outstanding for all remaining Fiscal Years prior to the issuance of such refunding Parity Obligations; or (B) then Outstanding Balloon Indebtedness, Tender Indebtedness or Variable Rate Indebtedness, but only to the extent that the principal amount of such indebtedness has been put, tendered to or otherwise purchased pursuant to a standby purchase or other liquidity facility relating to such indebtedness.

(f) Without regard to paragraph (c) above, if (A) no Event of Default has occurred and is continuing and (B) no event of default or termination event attributable to an act of or failure to act by the City under any Qualified Swap Agreement or Credit Support Instrument has occurred and is continuing, the City may issue or incur Subordinated Obligations, and such Subordinated Obligations shall be paid in accordance with the provisions of the Installment Purchase Agreement, provided that:

(i) City obtains or provides a certificate or certificates, prepared by the City or at the City's option by a Consultant, showing that:

(1) the Net System Revenues as shown by the books of the City for any 12-consecutive-month period within the 18 consecutive months ending immediately prior to the incurring of such additional Subordinated Obligations shall have amounted to at least 1.00 times the Maximum Annual Debt Service on all Obligations to be Outstanding immediately after the issuance of the proposed Subordinated Obligations; or

(2) the estimated Net System Revenues for the five Fiscal Years following the earlier of (i) the end of the period during which interest on those Subordinated Obligations is to be capitalized or, if no interest is to be capitalized, the Fiscal Year in which the Subordinated Obligations are issued; or (ii) the date on which substantially all new facilities financed with such Subordinated Obligations are expected to commence operations, will be at least equal to 1.00 times the Maximum Annual Debt Service on all Obligations to be Outstanding immediately after the issuance of the proposed Subordinated Obligations.

(ii) For purposes of preparing the certificate or certificates described in clause (1) of paragraph (f)(i) above, the City and its Consultant(s) may rely upon audited financial statements or, if audited financial statements for the period are not available, financial statements prepared by the City that have not been subject to audit by an Independent Certified Public Accountant.

(iii) For purposes of the computations to be made as described in clause (2) of paragraph (f)(i) above, the determination of Net System Revenues:

(i) may take into account any increases in rates and charges which relate to the Water System and which have been approved by the City Council and shall take into account any reduction in such rates and charges which have been approved by the City Council, which will, for purposes of the test described in clause (2) of paragraph (f)(i) above, be effective during any Fiscal Year ending within the five-Fiscal-Year period for which such estimate is made; and

(ii) may take into account an allowance for any estimated increase in such Net System Revenues from any revenue-producing additions or improvements to or extensions of the Water System to be made with the proceeds of such additional indebtedness, with the proceeds of Obligations previously issued or with cash contributions made or to be made by the City, all in an amount equal to the estimated additional average annual Net System Revenues to be derived from such additions, improvements and extensions during the five-Fiscal-Year-period contemplated by clause (2) of paragraph (f)(i) above, all as shown by such certificate of the City or its Consultant, as applicable; and

(iii) for the period contemplated by clause (2) of paragraph (f)(i) above, shall initially include Maintenance and Operation Costs of the Water System in an amount equal to such costs for any 12-consecutive month period within the 24 consecutive months ending immediately prior to incurring such Subordinated Obligations for the first Fiscal Year of the five-Fiscal-Year period, but adjusted if deemed necessary by the City or its Consultant, as applicable, for any increased Maintenance and Operations Costs of the Water System which are, in the judgment of the City or its Consultant, as applicable, essential to maintaining and operating the Water System and which will occur during any Fiscal Year ending within the period contemplated by clause (2) of paragraph (f)(i) above.

(iv) The certificate or certificates described above in paragraph (f)(i) above shall not be required if the Subordinated Obligations being issued are for the purpose of refunding (i) then-Outstanding Parity Obligations or Subordinated Obligations if at the time of the issuance of such Subordinated Obligations a certificate of an Authorized City Representative shall be delivered showing that the sum of Debt Service for all remaining Fiscal Years on all Parity Obligations and Subordinated Obligations Outstanding after the issuance of the refunding Subordinated Obligations will not exceed the sum of Debt Service for all remaining Fiscal Years on all Parity Obligations and Subordinated Obligations Outstanding prior to the issuance of such refunding Subordinated Obligations; or (ii) then-Outstanding Balloon Indebtedness, Tender Indebtedness or Variable Rate Indebtedness, but only to the extent that the principal amount of such indebtedness has been put, tendered to or otherwise purchased by a standby purchase agreement or other liquidity facility relating to such indebtedness.

Covenants of the City

Compliance With Installment Purchase Agreement and Ancillary Agreements. (a) The City will punctually pay Parity Obligations in strict conformity with the terms of the Agreement and thereof; and will faithfully observe and perform all the agreements, conditions, covenants and terms contained herein required to be observed and performed by it, and will not terminate the Installment Purchase Agreement for any cause including, without limiting the generality of the foregoing, any acts or circumstances that may constitute failure of consideration, destruction of or damage to the Project, commercial frustration of purpose, any change in the tax or other laws of the United States of America or of the State or any political subdivision of either or any failure of the Corporation to observe or perform any agreement, condition, covenant or term contained herein required to be observed and performed by it, whether express or implied, or any duty, liability or obligation arising out of or connected herewith or the insolvency, or deemed insolvency, or bankruptcy or liquidation of the Corporation or any force majeure, including acts of God, tempest, storm, earthquake, war, rebellion, riot, civil disorder, acts of public enemies, blockade or embargo, strikes, industrial disputes, lock outs, lack of transportation facilities, fire, explosion, or acts or regulations of governmental authorities.

(b) The City will faithfully observe and perform all the agreements, conditions, covenants and terms contained in the Installment Purchase Agreement, including Supplements, and any Issuing Instrument, Credit Support Instrument or Qualified Swap Agreement relating to Parity Obligations required to be observed and performed by it, and it is expressly understood and agreed by and between the parties to the Agreement that each of the agreements, conditions, covenants and terms contained therein is an essential and material term of the purchase of and payment for each Component by the City pursuant to, and in accordance with, and as authorized under the Law.

(c) The City will faithfully observe and perform all of the agreements and covenants of the City contained in each Authorizing Ordinance and will not permit the same to be amended or modified so as to adversely affect the Owners of Installment Payment Obligations or the counterparty to any Qualified Swap Agreement that is in effect.

(d) The City shall be unconditionally and irrevocably obligated, so long as any Installment Payment Obligations remain Outstanding and unpaid, to take all lawful action necessary or required to continue to entitle the City to collect and deposit such System Revenues in the Water Utility Fund for use as provided in the Agreement; provided, however, that such obligation does not, in any way, limit the City's ability to undertake any and all legal actions, including any appeals, in the defense of a federal court order dictating a water system configuration other than that approved and adopted by the City.

Against Encumbrances. The City will not make any pledge of or place any lien on the Net System Revenues except as otherwise provided or permitted in the Agreement.

Debt Service Reserve Fund. The City will maintain or cause to be maintained each Reserve Fund at the applicable Reserve Requirement. In the event the amount in any such fund or account falls below the applicable Reserve Requirement, the City will replenish such fund or account up to the applicable Reserve Requirement pursuant to the Agreement.

Against Sale or Other Disposition of Property. (a) The City will not sell, lease or otherwise dispose of the Water System or any part thereof essential to the proper operation of the Water System or to the maintenance of the System Revenues, except as provided in the Agreement. Further, the City will not, except as otherwise provided herein, enter into any agreement or lease which impairs the operation of the Water System or any part thereof necessary to secure adequate Net System Revenues for the payment of the Parity Obligations or which would otherwise impair the rights of the Corporation with respect to the System Revenues or the operation of the Water System.

(b) The City may dispose of any of the works, plant properties, facilities or other parts of the Water System, or any real or personal property comprising a part of the Water System, only upon the approval of the City Council and consistent with one or more of the following:

(i) the City in its discretion may carry out such a disposition if the facilities or property being disposed of are not material to the operation of the Water System, or shall have become unserviceable, inadequate, obsolete or unfit to be used in the operation of the Water System or are no longer necessary, material or useful to the operation of the Water System, and if such disposition will not materially reduce the Net System Revenues and if the proceeds of such disposition are deposited in the Water Utility Fund;

(ii) the City in its discretion may carry out such a disposition if the City receives from the acquiring party an amount equal to the fair market value of the portion of the Water System disposed of. As used in this clause (ii), "fair market value" means the most probable price that the portion being disposed of should bring in a competitive and open market under all conditions requisite to a fair sale, the willing buyer and willing seller each acting prudently and knowledgeably, and assuming that the price is not affected by coercion or undue stimulus. The proceeds of the disposition shall be used (A) *first*, promptly to redeem, or irrevocably set aside for the redemption of, Parity Obligations, and *second*, promptly to redeem, or irrevocably set aside for the redemption of, Subordinated Obligations, and/or (B) to provide for a part of the cost of additions to and betterments and extensions of the Water System; provided, however, that before any such disposition under this clause (2), the City must obtain (i) a certificate of an Independent Engineer to the effect that upon such disposition and the use of the proceeds of the disposition as proposed by the City, the remaining portion of the Water System will retain its operational integrity and the estimated Net System Revenues for the five Fiscal Years following the Fiscal Year in which the disposition is to occur will be equal to or exceed the greater of (i) at least 1.20 times the Adjusted Debt Service on all Outstanding Parity Obligations during the five Fiscal Years following the Fiscal Year in which the disposition is to occur, or (ii) at least 1.00 times the Adjusted Debt Service on all Outstanding Obligations during the first five Fiscal Years following the Fiscal Year in which the disposition is to occur, taking into account (aa) the reduction in revenue resulting from the disposition, (bb) the use of any proceeds of the disposition for the redemption of Parity Obligations and/or Subordinated Obligations, (cc) the Independent Engineer's estimate of revenue from customers anticipated to be served by any additions to and betterments and extensions of the Water System financed in part by the proceeds of the disposition, and (dd) any other adjustment permitted in the preparation of a certificate under Section 5.03(c)(2)(B) of the Installment Purchase Agreement, and (ii) confirmation from the Rating Agencies to the effect that the rating then in effect on any Outstanding Parity Obligations will not be reduced or withdrawn upon such disposition.

(c) The City will operate the Water System in an efficient and economic manner, *provided* that the City may remove from service on a temporary or permanent basis such part or parts of the Water System as the City shall determine, so long as (1) Net System Revenues are at least equal to the greater of (i) 100% of all Obligations payable in the then-current Fiscal Year or (ii) 120% of Adjusted Debt Service for the then-current Fiscal Year, after giving effect to any defeasance of Parity Obligations and/or Subordinated Obligations occurring incident to such removal, and for each Fiscal Year thereafter to and including the Fiscal Year during which the last Installment Payment is due, after giving effect to such defeasance, as evidenced by (i) an Engineer's Report on file with the City, or (ii) a Certificate of the City, (2) the value of the parts of the Water System to be so removed is less than 5% of the total Water System Plant assets, each as shown on the most recent audited financial statements that include the Water Utility Fund, and (3) the City shall have filed with each Trustee an opinion of Bond Counsel to the effect that the removal of such part or parts of the Water System will not adversely affect the exclusion from gross income for federal income tax purposes of the interest on Tax-Exempt Installment Payment Obligations.

Prompt Acquisition and Construction. The City shall take all necessary and appropriate steps to construct, acquire and install the Project, as agent of the Corporation, with all practicable dispatch and in an expeditious manner and in conformity with law so as to complete the same as soon as possible.

Maintenance and Operation of the Water System; Budgets. The City shall maintain and preserve the Water System in good repair and working order at all times and shall operate the Water System in an efficient and economical manner and will pay all Maintenance and Operation Costs of the Water System as they become due and payable. The City shall adopt and make available to the Corporation, on or before the effective date hereof, a budget approved by the City Council of the City setting forth the estimated Maintenance and Operation Costs of the Water System for the period from such date until the close of the then-current Fiscal Year. On or before August 1 of each Fiscal Year, the City shall adopt, and on or before the day that is 120 days after the beginning of the Fiscal Year, make available to the Corporation a budget approved by the City Council of the City setting forth the estimated Maintenance and Operation Costs of the Water System for such Fiscal Year. Any budget may be amended at any time during any Fiscal Year and such amended budget shall be filed by the City with the Corporation.

Amount of Rates and Charges; Rate Stabilization Fund; Other Funds.

(a) The City shall fix, prescribe and collect rates and charges for the Water Service which will be at least sufficient to yield the greater of (1) Net System Revenues sufficient to pay during each Fiscal Year all Obligations payable in such Fiscal Year or (2) *Adjusted Net System Revenues during each Fiscal Year equal to 120% of the Adjusted Debt* Service for such Fiscal Year. The City may make adjustments from time to time in such rates and charges and may make such classification thereof as it deems necessary, but shall not reduce the rates and charges then in effect unless the Net System Revenues from such reduced rates and charges will at all times be sufficient to meet the requirements of these provisions.

(b) The City may establish, as a fund within the Water Utility Fund, a fund denominated the "Rate Stabilization Fund." From time to time, the City may deposit into the Rate Stabilization Fund, from current System Revenues, such amounts as the City shall determine and the amount of available current System Revenues shall be reduced by the amount so transferred. Amounts may be transferred from the Rate Stabilization Fund solely and exclusively to pay Maintenance and Operation Costs of the Water System, and any amounts so transferred shall be deemed System Revenues when so transferred. All interest or other earnings upon amounts in the Rate Stabilization Fund may be withdrawn therefrom and accounted for as System Revenues.

(c) The City may establish, as a fund within the Water Utility Fund, a fund denominated the "Secondary Purchase Fund." From time to time, the City may deposit in the Secondary Purchase Fund, from any lawful source, which may or may not consist of current System Revenues, such amounts as the City shall determine, and the amount of available System Revenues shall be reduced by the amount so transferred, but only to the extent that amounts so transferred consist of then-current System Revenues. Amounts may be transferred from the Secondary Purchase Fund solely and exclusively to pay Maintenance and Operation Costs of the Water System, and any amounts so transferred shall be deemed System Revenues when so transferred. All interest or other earnings upon amounts in the Secondary Purchase Fund may be withdrawn therefrom and accounted for as System Revenues.

Payment of Claims. The City will pay and discharge any and all lawful claims for labor, materials or supplies which, if unpaid, might become a lien on the System Revenues or any part thereof or on any funds in the hands of the City or the Trustee might impair the security of the Installment Payments, but the City shall not be required to pay such claims if the validity thereof shall be contested in good faith.

Compliance with Contracts. The City will comply with, keep, observe and perform all agreements, conditions, covenants and terms, express or implied, required to be performed by it contained in all contracts for the use of the Water System and all other contracts affecting or involving the Water System to the extent that the City is a party thereto.

Insurance. (a) The City will procure and maintain or cause to be procured and maintained insurance on the Water System with responsible insurers, in such amounts and against such risks (including accident to or destruction of the Water System) as are usually covered in connection with water systems similar to the Water System, or it will self-insure or participate in an insurance pool or pools with reserves adequate, in the reasonable judgment of the City, to protect the Water System against loss. In the event of any damage to or destruction of the Water System caused by the perils covered by such insurance or self insurance, the Net Proceeds thereof shall be applied to the reconstruction, repair or replacement of the damaged or destroyed portion of the Water System. The City shall begin such reconstruction, repair or replacement promptly after such damage or destruction shall occur, and shall continue and properly complete such reconstruction, repair or replacement as expeditiously as possible, and shall pay out of such Net Proceeds all costs and expenses in connection with such reconstruction, repair or replacement so that the same shall be completed and the Water System shall be free and clear of all claims and liens unless the City determines that such property or facility is not necessary to the efficient or proper operation of the Water System and therefore determines not to reconstruct, repair or replace such project or facility. If such Net Proceeds exceed the costs of such reconstruction, repair or replacement, then the excess Net Proceeds shall be deposited in the Water Utility Fund and be available for other proper uses of funds deposited in the Water Utility Fund.

(b) The City will procure and maintain such other insurance which it shall deem advisable or necessary to protect its interests and the interests of the Corporation, which insurance shall afford protection in such amounts and against such risks as are usually covered in connection with water systems similar to the Water System; provided that any such insurance may be maintained under a self-insurance program so long as such self-insurance is maintained in the amounts and in the manner usually maintained in connection with water systems similar to the Water System.

(c) All policies of insurance required to be maintained under the Agreement shall, to extent reasonably obtainable, provide that the Corporation and each Trustee shall be given 30 days' written notice of any intended cancellation thereof or reduction of coverage provided thereby. The City shall certify to the Corporation and each Trustee annually on or before August 31 that it is in compliance with the insurance requirements hereunder.

Accounting Records; Financial Statements and Other Reports. (a) The City will keep appropriate accounting records in which complete and correct entries shall be made of all transactions relating to the Water System, which records shall be available for inspection by the Corporation and the Trustee at reasonable hours and under reasonable conditions.

(b) The City will prepare and file with the Corporation annually (commencing with the Fiscal Year ending June 30, 1998), within 270 days of the close of each Fiscal Year, financial statements that include the Water Utility Fund for the preceding Fiscal Year prepared in accordance with generally accepted accounting principles, together with an Accountant's Report thereon.

(c) The City will furnish a copy of the financial statements referred to in paragraph (b) above to any Owner of the Certificates requesting a copy thereof, which may be in electronic form.

Payment of Taxes and Compliance with Governmental Regulations. The City shall pay and discharge all taxes, assessments and other governmental charges which may hereafter be lawfully imposed upon the Water System or any part thereof or upon the System Revenues when the same shall become due, except that the City may contest in good faith any taxes, assessments and other governmental charges so long as the City shall have budgeted for the amount being contested and, if appropriate, such amount shall have been included as a Maintenance and Operation Costs of the Water System. The City shall duly observe and conform with all valid regulations and requirements of any governmental authority relative to the operation of the Water System or any part thereof, but the City shall not be required to comply with any regulations or requirements so long as the validity or application thereof shall be contested by the City in good faith.

Collection of Rates and Charges; No Free Service. The City shall have in effect at all times rules and regulations for the payment of bills for Water Service. Such regulations may provide that where the City furnishes water to the property receiving Water Service, the Water Service charges shall be collected together with the water rates upon the same bill providing for a due date and a delinquency date for each bill. In each case where such bill remains unpaid in whole or in part after it becomes delinquent, the City may disconnect such premises from the Water System, and such premises shall not thereafter be reconnected to the Water System except in accordance with City operating rules and regulations governing such situations of delinquency. To the extent permitted by law, the City shall not permit any part of the Water System or any facility thereof to be used or taken advantage of free of charge by any authority, firm or person, or by any public agency (including the United States of America, the State and any city, county, district, political subdivision, public authority or agency thereof).

Eminent Domain Proceeds. If all or any part of the Water System shall be taken by eminent domain proceedings, then subject to the provisions of any Authorizing Ordinance, the Net Proceeds thereof shall be applied to the replacement of the property or facilities so taken, unless the City determines that such property or facility is not necessary to the efficient or proper operation of the Water System and therefore determines not to replace such property or facilities. Any Net Proceeds of such award not applied to replacement or remaining after such work has been completed shall be deposited in the Water Utility Fund and be available for other proper uses of funds deposited in the Water Utility Fund.

Tax Covenants. There shall be included in each Supplement relating to Tax-Exempt Installment Payment Obligations such covenants as are deemed necessary or appropriate by Bond Counsel for the purpose of assuring that interest on such Installment Payment Obligations shall be excluded from gross income under section 103 of the Code.

Subcontracting. Nothing contained in the Installment Purchase Agreement to the contrary shall prevent the City from delegating the power to be an operator of some or all of the Water System, even though the City continues to retain ownership of the Water System and its operations, and no such subcontracting arrangement shall relieve the City of any of its obligations hereunder. Prior to the effective date of any such delegation, the City shall deliver to the Trustee an opinion of Bond Counsel to the effect that the proposed delegation will not have an adverse effect on the exclusion from gross income for federal income tax purposes of the interest component of Tax-Exempt Installment Payment Obligations.

Prepayments of Installment Payments

Prepayment of Installment Payments. Provisions may be made in any Supplement for the prepayment of Installment Payments, in whole or in part, in such multiples and in such order of maturity and from funds of any source, and with such prepayment premiums and other terms as are specified in the Supplement. Said Supplement shall also provide for any notices to be given relating to such prepayment.

Events of Default and Remedies of the Corporation

Events of Default and Acceleration of Maturities. If one or more of the following Events of Default shall happen, that is to say:

(a) if default shall be made in the due and punctual payment of or on account of any Parity Obligation as the same shall become due and payable;

(b) if default shall be made by the City in the performance of any of the agreements or covenants required herein to be performed by it (other than as specified in subsection (a) above), and such default shall have continued for a period of 60 days after the City shall have been given notice in writing of such default by the Corporation or any Trustee;

(c) if any Event of Default specified in any Supplement, Authorizing Ordinance or Issuing Instrument shall have occurred and be continuing; or

(d) if the City shall file a petition or answer seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or if a court of competent jurisdiction shall approve a petition filed with the consent of the City seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or if under the provisions of any other law for the relief or aid of debtors any court of competent jurisdiction shall assume custody or control of the City or of the whole or any substantial part of its property;

then, and in each and every such case during the continuance of such Event of Default, the Corporation shall upon the written request of the Owners of 25% or more of the aggregate principal amount of all Series of Parity Installment Obligations Outstanding, voting collectively as a single class, by notice in writing to the City, declare the entire unpaid principal amount thereof and the accrued interest thereon to be due and payable immediately, and upon any such declaration the same shall become immediately due and payable, anything contained herein to the contrary notwithstanding; provided, that with respect to a Series of Parity Installment Obligations which is credit enhanced by a Credit Support Instrument, acceleration shall not be effective unless the declaration is consented to by the related Credit Provider and, provided further, that nothing herein shall affect the rights of the parties to a Qualified Swap Agreement to terminate such Qualified Swap Agreement. The foregoing provisions, however, are subject to the condition that if at any time after the entire principal amount of all Parity Installment Obligations and the accrued interest thereon shall have been so declared due and payable and before any judgment or decree for the payment of the moneys due shall have been obtained or entered, the City shall deposit with the Corporation a sum sufficient to pay the unpaid principal amount of all such Parity Installment Obligations and the unpaid payments of any other Parity Obligations referred to in clause (a) above due prior to such declaration and the accrued interest thereon, with interest on such overdue installments at the rate or rates applicable thereto in accordance with their terms, and the reasonable expenses of the Corporation, and any and all other defaults known to the Corporation (other than in the payment of the entire principal amount of the unpaid Parity Installment Obligations and the accrued interest thereon due and payable solely by reason of such declaration) shall have been made good or cured to the satisfaction of the Corporation or provision deemed by the Corporation to be adequate shall have been made therefor, then and in every such case the Corporation, by written notice to the City, may rescind and annul such declaration and its consequences; but no such rescission and annulment shall extend to or shall affect any subsequent default or shall impair or exhaust any right or power consequent thereon.

The Owners of Subordinated Obligations may enforce the provisions of the Agreement for their benefit by appropriate legal proceedings. The payment of Subordinated Obligations will be subordinated in right of payment to payment of the Parity Obligations (except for any payment in respect of Subordinated Obligations from the Reserve Fund securing such Subordinated Obligations). Upon the occurrence and during the continuance of any Event of Default, Owners of Parity Obligations will be entitled to receive payment thereof in full before the Owners of Subordinated Obligations are entitled to receive payment thereof (except for any payment in respect of Subordinated Obligations from the Reserve Fund securing such Subordinated Obligations) and the Owners of the Subordinated Obligations will become subrogated to the rights of the Owners of Parity Obligations to receive payments with respect thereto.

Application of Net System Revenues Upon Acceleration. All Net System Revenues received after the date of the declaration of acceleration by the Corporation as provided in the Agreement shall be applied in the following order:

(a) First, to the payment of the costs and expenses of the Corporation and the Trustee, if any, in carrying out the provisions of the Agreement, including reasonable compensation to its accountants and counsel;

(b) Second, to the payment of the entire principal amount of the unpaid Parity Installment Obligations and the unpaid principal amount of all other Parity Obligations and the accrued interest thereon, with interest on the overdue installments at the rate or rates of interest applicable thereto in accordance with their respective terms. In the event there are insufficient Net System Revenues to pay the entire principal amount of and accrued interest on all Parity Obligations, then accrued interest (and payments due to the counterparty to a Qualified Swap Agreement) shall first be paid and any remaining amount shall be paid on account of principal, and in the event there are insufficient Net System Revenues to fully pay either interest or principal in accordance with the foregoing, then payment shall be prorated within a priority based upon the total amounts due in that priority; and

(c) Third, to the payment of the entire principal amount of the unpaid Subordinated Obligations and the accrued interest thereon, with interest on the overdue installments at the rate or rates of interest applicable thereto in accordance with their respective terms. In the event there are insufficient Net System Revenues to pay the entire principal amount of and accrued interest on all Subordinated Obligations, then accrued interest shall first be paid and any remaining amount shall be paid on account of principal, and in the event there are insufficient Net System Revenues to fully pay either interest or principal in accordance with the foregoing, then payment shall be prorated within a priority based upon the total amounts due in that priority.

Discharge of Installment Payment Obligations

Discharge of Installment Payment Obligations. If the City shall pay or cause to be paid or there shall otherwise be paid to the Owners all Outstanding Installment Payment Obligations of a Series, the principal thereof and the interest and redemption premiums, if any, thereon or if all such Outstanding Installment Payment Obligations shall be deemed to have been paid at the times and in the manner stipulated in the applicable Issuing Instrument, then, as to any such Series, all agreements, covenants and other obligations of the City hereunder shall thereupon cease, terminate and become void and be discharged and satisfied, except for the obligation of the City to pay or cause to be paid all sums due under the Agreement.

Miscellaneous

Liability of City Limited to System Revenues.

(a) Notwithstanding anything contained in the Installment Purchase Agreement, the City shall not be required to advance any moneys derived from any source of income other than the Net System Revenues and the other funds provided herein for the payment of the Installment Payments or for the performance of any other agreements or covenants required to be performed by it contained herein. The City may, however, but in no event shall be obligated to, advance moneys for any such purpose so long as such moneys are derived from a source legally available for such purpose and may be legally used by the City for such purpose.

(b) The obligation of the City to make the Installment Payments is a special obligation of the City payable solely from such Net System Revenues and other funds provided for herein, and does not constitute a debt of the City or of the State of California or of any political subdivision thereof within the meaning of any constitutional or statutory debt limitation or restriction.

Amendments. (a) The Agreement may be amended with respect to a Series of Installment Payment Obligations in writing as may be mutually agreed by the City and the Corporation, with the written consent of any Credit Provider for any Installment Payment Obligations or, as to Installment Obligations for which there is no Credit Support Instrument, the Owners of a majority in aggregate principal amount of such Series of Installment Payment Obligations then Outstanding, provided that no such amendment shall (1) extend the payment date of any Installment Payment, or reduce the amount of any Installment Payment without the prior written consent of the Owner of each Obligation so affected; or (2) reduce the percentage of Installment Payment Obligations the consent of the Owners of which is required for the execution of any amendment of the Agreement without the prior written consent of each of the Owners so affected.

(b) Notwithstanding subsection (a) above, the City agrees that, so long as it shall have any obligations under a Qualified Swap Agreement, it shall not amend or modify, or consent to the amendment or modification of, the Agreement that would in any way adversely affect (1) the rights of a counterparty to a Qualified Swap Agreement hereunder, or (2) the obligations of the City hereunder to such a counterparty without the prior written consent of such Qualified Swap Provider.

(c) The Agreement and the rights and obligations of the City and the Corporation thereunder may also be amended for supplemented at any time by an amendment hereof or supplement hereto which shall not adversely affect the interests of the Owners of the Installment Payment Obligations and which shall become binding upon execution by the City and the Corporation, without the written consents of any Owner of Installment Payment Obligations or any Credit Provider, but only to the extent permitted by law and only upon receipt of an unqualified opinion of Bond Counsel to the effect that such amendment or supplement is permitted by the provisions of the Agreement and is not inconsistent with the Agreement and does not adversely affect the exclusion of the interest portion of the Installment Payments received by the Owners from gross income for federal income tax purposes, and only for any one or more of the following purposes:

(1) to add to the covenants and agreements of the Corporation or the City contained in the Agreement other covenants and agreements thereafter to be observed or to surrender any right or power herein reserved to or conferred upon the Corporation or the City;

(2) to cure, correct or supplement any ambiguous or defective provision contained in the Agreement or in regard to questions arising under the Agreement, as the Corporation or the City may deem necessary or desirable;

(3) to make other amendments or modifications which shall not materially adversely affect the interests of the Owners of the Installment Payment Obligations;

(4) to provide for the issuance of Parity Installment Payment Obligations; and

(5) to provide for the issuance of Subordinated Obligations.

Net Contract. The Agreement shall be deemed and construed to be a net contract, and the City shall pay absolutely net during the term hereof the Installment Payments and all other payments required hereunder, free of any deductions and without abatement, diminution or setoff whatsoever.

2009A SUPPLEMENT TO MASTER INSTALLMENT AGREEMENT

The 2009A Supplement to Master Installment Agreement sets forth certain terms and conditions of the purchase of the Refunded Components of the Project by the City. Certain definitions and provisions of the 2009A Supplement are given and summarized below.

Selected Definitions

2009A Installment Payment Date

The term "2009A Installment Payment Date" means the 15th day of the calendar month immediately preceding each Interest Payment Date for the 2009A Bonds.

Interest Portion

The term "Interest Portion" means the interest portion of 2009A Installment Payments specified in the 2009A Supplement.

Principal Portion

The term "Principal Portion" means the principal portion of 2009A Installment Payments specified in the 2009A Supplement.

Purchase Price

The term "Purchase Price" means the purchase price of the Refunded Components.

Refunded Components

The term "Refunded Components" means the Components of the Project specified in Exhibit A attached to the 2009A Supplement, originally comprising portions of the 1998 Project and the 2007A Project, for some of which the City will be making 2009A Installment Payments.

2009A Installment Payments

The term "2009A Installment Payments" means the Installment Payments specified in the 2009A Supplement which are to pay the Purchase Price of the Refunded Components in accordance with the terms the 2009A Supplement.

Subordinated Supplements

The term "Subordinated Supplements" means the 2002 Supplement to Master Installment Purchase Agreement, dated as of October 1, 2002, the 2007A Supplement to Master Installment Purchase Agreement, dated as of January 1, 2007, the 2008A Supplement to Master Installment Purchase Agreement, dated as of February 1, 2008, each by and between the City and the Corporation, and each being a supplement to the Agreement, and any additional supplements to the Agreement.

General. Pursuant to the 2009A Supplement, the City agrees to purchase the Refunded Components from the Corporation, and to pay the 2009A Installment Payments therefor. See the caption, "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2009A BONDS – 2009A INSTALLMENT PAYMENTS" in this Official Statement.

Additional Covenants relating to Tax Exemption.

(a) The City shall not directly or indirectly use or permit the use of any proceeds of the 2009A Bonds or any other funds of the City or of the Refunded Components or take or omit to take any action that would cause the 2009A Bonds to be "private activity bonds" within the meaning of section 141 of the Code, or obligations that are "federally guaranteed" within the meaning of section 149(b) of the Code.

(b) The City covenants that it will not take any action, or fail to take any action, if any such action or failure to take action would adversely affect the exclusion from gross income of the interest on the 2009A Bonds under section 103 of the Code. The City shall not directly or indirectly use or permit the use of any proceeds of the 2009A Bonds or any other funds of the City, or take or omit to take any action, that would cause the 2009A Bonds to be "arbitrage bonds" within the meaning of section 148(a) of the Code.

(c) Without limiting the generality of the foregoing, the City agrees that there shall be paid from time to time all amounts required to be rebated to the United States of America pursuant to section 148(f) of the Code and any Treasury Regulations as may be applicable to the 2009A Bonds from time to time. The City hereby specifically covenants to pay or cause to be paid to the United States of America at the times and in the amounts determined under this Section the Rebate Requirement, as described in the Tax Certificate, and to otherwise comply with the provisions of the Tax Certificate executed by the City in connection with the execution and delivery of the 2009A Bonds.

(d) Notwithstanding any provision of the 2009A Supplement, if the City provides to the Trustee an opinion of Bond Counsel to the effect that any action required under this Section is no longer required, or to the effect that some further action is required, to maintain the exclusion from gross income of the interest on the 2009A Bonds pursuant to section 103 of the Code, then the City may rely conclusively on such opinion in complying with the provisions the 2009A Supplement, and the covenants under the 2009A Supplement shall be deemed to be modified to that extent.

Continuing Disclosure. The City covenants and agrees that it will comply with and carry out all of the provisions of the Continuing Disclosure Certificate delivered in connection with the 2009A Bonds. Notwithstanding any other provision of the 2009A Supplement, failure of the City to comply with the Continuing Disclosure Certificate shall not be considered a default of any kind under the 2009A Supplement or the Continuing Disclosure Certificate; however, the Trustee may (and, at the request of any Participating Underwriter or the Owners of at least twenty-five percent (25%) in aggregate principal amount of the 2009A Bonds, shall) or any Owner or Beneficial Owner may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the City to comply with its obligations under the 2009A Supplement.

ASSIGNMENT AGREEMENT

The Assignment Agreement providers for the transfer, assignment and setting over by the Corporation to the Trustee, for the benefit of the Owners of the 2009A Bonds, all of the

Corporation's rights under the 2009A Supplement, excepting only certain rights of the Corporation to be indemnified by the City, but including (a) the right to receive and collect all of the 2009A Installment Payments and prepayments from the City, (b) the right to receive and collect any proceeds of any insurance of the Water System maintained pursuant to the Installment Purchase Agreement, or any proceeds of sale of portions of the Water System, permitted pursuant to the Installment Purchase Agreement, and (c) the right to exercise such rights and remedies conferred on the Corporation by the 2009A Supplement as may be necessary or convenient to (1) enforce payment of the 2009A Installment Payments, prepayments and any other amounts required to be deposited into the Payment Fund, the Redemption Account or otherwise under the Indenture, or (2) otherwise protect the interests of the Corporation in the event of a default by the City under the Installment Purchase Agreement. The Trustee accepts such assignment, subject to the provisions of the Indenture.

APPENDIX F

FORM OF BOND COUNSEL OPINION

__________, 2009

Public Facilities Financing Authority of the City of San Diego
202 C Street, 7th Floor
San Diego, California 92101

Re: $__________ Public Facilities Financing Authority of the City of San Diego Water Revenue Bonds, Refunding Series 2009A and Series 2009B (Payable Solely from Installment Payments Secured by Net System Revenues of the Water Utility Fund)

Ladies and Gentlemen:

In our role as Bond Counsel to the Public Facilities Financing Authority of the City of San Diego (the "Authority"), we have examined certified copies of the proceedings taken in connection with the issuance by the Authority of $________ aggregate principal amount of its Water Revenue Bonds, Refunding Series 2009A and Series 2009B (Payable Solely from Installment Payments Secured by Net System Revenues of the Water Utility Fund) (collectively, the "Bonds"). We have also examined supplemental documents furnished to us and have obtained such certificates and documents from public officials as we have deemed necessary for the purposes of this opinion. The Bonds are issued under Article 4 of Chapter 5 of Division 7 of Title 1 of the California Government Code (the "Bond Law"), pursuant to an Indenture (the "Indenture"), dated as of January 1, 2009, by and between the Authority and Wells Fargo Bank, National Association, as trustee (the "Trustee"), and pursuant to Resolution No. FA-2008-___ of the Board of Commissioners of the Authority, adopted __________, 2008. The City of San Diego (the "City") has entered into a 2009 Supplement to Amended and Restated Master Installment Purchase Agreement with the San Diego Facilities and Equipment Leasing Corporation (the "Corporation"), dated as of January 1, 2009 (the "2009 Supplement"), which supplemented the Amended and Restated Master Installment Purchase Agreement, by and between the City and the Corporation, dated as of January 1, 2009 (the "Master Agreement," and together with the 2009 Supplement, the "Installment Purchase Agreement"). Capitalized terms used herein and not otherwise defined shall have the meanings assigned to them in the Indenture and the Installment Purchase Agreement, as applicable.

As bond counsel, we have examined copies certified to us as being true and complete copies of the proceedings of the Authority, the City and the Corporation for the authorization and issuance of the Bonds, including the Indenture, the Installment Purchase Agreement and the Tax Exemption Certificate of the Authority and the City, dated the date hereof (the "Tax Certificate"). Our services as bond counsel were limited to an examination of such proceedings and to the rendering of the opinions set forth below. In this connection, we have also examined such certificates of public officials and officers of the Authority, the City and the Corporation as we have considered necessary for the purposes of this opinion.

Certain agreements, requirements and procedures contained or referred to in the Indenture, the Installment Purchase Agreement, the Tax Certificate and other relevant documents may be changed and certain actions (including, without limitation, defeasance of the Bonds) may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents. No opinion is expressed herein as to any Bond or the tax treatment under federal law or the laws of the State of

California of the interest thereon if any such change occurs or action is taken or omitted upon the advice or approval of counsel other than ourselves.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions or events are taken or do occur. Our engagement with respect to the Bonds has concluded with their issuance, and we disclaim any obligation to update this letter. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by any parties other than the Authority, the City and the Corporation. We have not undertaken to verify independently, and have assumed, the accuracy of the factual matters represented, warranted or certified in the documents referred to in the second paragraph hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Indenture, the Installment Purchase Agreement and the Tax Certificate, including (without limitation) covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the Bonds to be included in gross income for federal income tax purposes. We call attention to the fact that the rights and obligations under the Bonds, the Indenture, the Installment Purchase Agreement and the Tax Certificate may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to the limitations on legal remedies against public entities in the State of California. We express no opinion with respect to any indemnification, contribution, choice of law, choice of forum or waiver provisions contained in the foregoing documents. We express no opinion and make no comment with respect to the sufficiency of the security or the marketability of the Bonds. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Bonds and express no opinion with respect thereto.

Based upon the foregoing, we are of the opinion that:

(a) The Indenture has been duly and validly authorized, executed and delivered by the Authority and, assuming such Indenture constitutes the legally valid and binding obligation of the Trustee, constitutes the legally valid and binding obligation of the Authority, enforceable against the Authority in accordance with its terms, and the Bonds are entitled to the benefits of the Indenture.

(b) The Installment Purchase Agreement has been duly and validly authorized, executed and delivered by the City and, assuming such Installment Purchase Agreement constitutes the legally valid and binding obligation of the Corporation, constitutes the legally valid and binding obligation of the City, enforceable against the City in accordance with its terms.

(c) The proceedings for the issuance of the Bonds have been taken in accordance with the laws and Constitution of the State of California, and the Bonds, having been issued in duly authorized form and executed by the proper officials and delivered to and paid for by the purchasers thereof, constitute legal and binding special obligations of the Authority enforceable in accordance with their terms.

(d) The Bonds are payable from the Revenues, subject to the application thereof on the terms and conditions as set forth in the Indenture and the Installment Purchase Agreement.

(e) It is further our opinion, based upon the foregoing, that pursuant to section 103 of the Internal Revenue Code of 1986, as amended and in effect on the date hereof (the "Code"), and existing regulations, published rulings, and court decisions thereunder, and assuming continuing compliance with the provisions of the Indenture and in reliance upon representations and certifications of the Corporation made in the Tax Certificate of even date herewith pertaining to the use, expenditure, and investment of the proceeds of the Bonds, when the Bonds are delivered to and paid for by the initial purchasers thereof, interest on the Bonds (1) will be excludable from the gross income, as defined in section 61 of the Code, of the owners thereof for federal income tax purposes, and (2) will not be included in computing the alternative minimum taxable income of the owners thereof who are individuals or, except as described below, corporations, for federal income tax purposes. We call to your attention that, with respect to our opinion in clause (2) above, interest on all tax-exempt obligations, such as the Bonds, owned by a corporation will be included in such corporation's adjusted current earnings for purposes of calculating the alternative minimum taxable income of such corporation, other than an S corporation, a qualified mutual fund, a real estate mortgage investment conduit (REMIC), a financial asset securitization investment trust (FASIT), or a real estate investment trust (REIT). A corporation's alternative minimum taxable income is the basis on which the alternative minimum tax imposed by section 55 of the Code is computed.

(f) In our opinion, under existing law, interest on the Bonds is exempt from personal income taxes of the State of California.

We express no other opinion with respect to any other federal, state, or local tax consequences under present law or any proposed legislation resulting from the receipt or accrual of interest on, or the acquisition or disposition of, the Bonds. Ownership of tax-exempt obligations such as the Bonds may result in collateral federal tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, certain S corporations with subchapter C earnings and profits, certain foreign corporations doing business in the United States, owners of an interest in a FASIT, individuals otherwise qualifying for the earned income tax credit, individual recipients of Social Security or Railroad Retirement benefits, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations.

Our opinions are based on existing law, which is subject to change. Such opinions are further based on our knowledge of facts as of the date hereof. We assume no duty to update or supplement our opinions to reflect any facts or circumstances that may thereafter come to our attention or to reflect any changes in any law that may thereafter occur or become effective.

Moreover, our opinions are not a guarantee of result and are not binding on the Internal Revenue Service or the State of California Franchise Tax Board; rather, such opinions represent our legal judgment based upon our review of existing law that we deem relevant to such opinions and in reliance upon the representations and covenants referenced above.

Respectfully submitted,

APPENDIX G

FORM OF CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate, dated as of January 1, 2009 (the "Disclosure Certificate") is executed and delivered by The City of San Diego (the "City") in connection with the issuance of $[Par Amount] Public Facilities Financing Authority of the City of San Diego Water Revenue Bonds, Refunding Series 2009A (Payable Solely From Installment Payments Secured By Net System Revenues of the Water Utility Fund) (the "Series 2009A Bonds"). The Series 2009A Bonds are being issued pursuant to that certain Indenture, dated as of January 1, 2009 (the "Indenture"), by and between the Public Finance Authority of the City of San Diego (the "Authority") and Wells Fargo Bank, National Association, as trustee. The proceeds of the Series 2009A Bonds are being used to pay or prepay a portion of the Outstanding Obligations (as defined in the Indenture), fund the reserve fund for the Series 2009A Bonds and pay costs of issuance with respect to the Series 2009A Bonds. In connection therewith, the City, as an "obligated person" with respect to the Series 2009A Bonds (within the meaning of the Rule, as defined herein), covenants and agrees as follows:

Section 1. Purpose of the Disclosure Certificate. This Disclosure Certificate is being executed and delivered by the City for the benefit of the holders and beneficial owners of the Series 2009A Bonds and in order to assist the Participating Underwriter in complying with the Rule.

Section 2. Definitions. In addition to the definitions set forth in the Indenture, which apply to any capitalized term used in this Disclosure Certificate unless otherwise defined in this Section, the following capitalized terms shall have the following meanings:

"Annual Report" shall mean any Annual Report provided by the City pursuant to, and as described in, Sections 3 and 4 of this Disclosure Certificate.

"Dissemination Agent" shall mean the City, acting in its capacity as Dissemination Agent hereunder, or any successor Dissemination Agent designated in writing by the City and which has filed with the City and the Trustee a written acceptance of such designation.

"Listed Events" shall mean any of the events listed in Section 5(a) of this Disclosure Certificate.

"National Repository" shall mean any Nationally Recognized Municipal Securities Information Repository for purposes of the Rule. The National Repositories currently recognized by the Securities and Exchange Commission are currently set forth in the SEC website located at http://www.sec.gov/info/municipal/nrmsir.htm.

"Official Statement" means the Official Statement, dated _______, 2008, relating to the Series 2009A Bonds.

"Participating Underwriter" shall mean any of the original Underwriters of the Series 2009A Bonds required to comply with the Rule in connection with offering of the Series 2009A Bonds.

"Repository" shall mean each National Repository and each State Repository, if any.

"Rule" shall mean Rule 15c2–12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

"State Repository" shall mean any public or private repository or entity designated by the State of California as a state repository for the purpose of the Rule and recognized as such by the Securities and Exchange Commission. As of the date of this Disclosure Certificate, there is no State Repository.

Section 3. Provision of Annual Reports.

(a) The City shall, or upon written direction shall cause the Dissemination Agent to, not later than 270 days after the end of the City's fiscal year (which currently ends June 30th), commencing with the report for the 2007-08 Fiscal Year (each, a "Filing Date"), provide to each Repository an Annual Report which is consistent with the requirements of Section 4 of this Disclosure Certificate for so long as the Series 2009A Bonds remain outstanding. Not later than fifteen (15) Business Days prior to each Filing Date, the City shall provide the Annual Report to the Dissemination Agent (if other than the City). The Annual Report may be submitted as a single document or as separate documents comprising a package, and may include by reference other information as provided in Section 4 of this Disclosure Certificate; provided that the audited financial statements of the City may be submitted separately from the balance of the Annual Report, and later than the Filing Date for the filing of the Annual Report, if not available by such Filing Date. If the City's fiscal year changes, it shall give notice of such change in the same manner as for a Listed Event under Section 5(c) hereof. The City shall provide a written certification with each Annual Report furnished to the Dissemination Agent to the effect that such Annual Report constitutes the Annual Report required to be furnished by it hereunder. The Dissemination Agent may conclusively rely upon such certification of the City and shall have no duty or obligation to review such Annual Report.

(b) If the City is unable to provide to the Repositories an Annual Report by the date required in subsection (a), the City shall send a notice to the Municipal Securities Rulemaking Board and any appropriate State Repository in substantially the form attached as Exhibit A..

(c) The Dissemination Agent shall:

(i) determine each year prior to the Filing Date the name and address of each National Repository and each State Repository, if any; and

(ii) if the Dissemination Agent is other than the City, and such information is available to it, file a report with the City certifying that the Annual Report has been provided pursuant to this Disclosure Certificate, stating the date it was provided and listing all the Repositories to which it was provided.

Section 4. Content of Annual Reports. The City's Annual Report shall contain or incorporate by reference the following:

(a) The audited financial statements for the most recently completed Fiscal Year prepared in accordance with generally accepted accounting principles as promulgated to apply to governmental entities from time to time by the Governmental Accounting Standards Board. If the City's audited financial statements are not available by the time the Annual Report is required to be filed pursuant to Section 3(a), the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the final Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.

(b) Financial information and operating data with respect to the City, as such information and data relate to the City's Water Department and the Water Utility Fund, for the most recently completed fiscal year of the type included in the Official Statement, in the following categories (to the extent not included in the City's audited financial statements):

(i) An update of the information contained in Table 1 (entitled "Historical Number of Retail Connections to Water System") of the Official Statement for the most recently completed fiscal year;

(ii) An update of the information contained in Table 2 (entitled "Major Non-Governmental Retail Customers and Top Governmental Customers") of the Official Statement for the most recently completed fiscal year;

(iii) An update of the information contained in Table 6 (entitled "Summary of Projected CIP Projects") of the Official Statement as of the end of the most recently completed fiscal year;

(iv) An update of the information contained in Table 7 (entitled "Five-Year Water Service Charge History for Single Family Residential Units and Other Domestic, Commercial, Industrial and Irrigation/Temporary Construction") of the Official Statement for the most recently completed fiscal year;

(v) An update of the information contained in Table 10 (entitled "Recent Rate History for Capacity Charges") of the Official Statement for the most recently completed fiscal year;

(vi) An update of the information contained in Table 11 (entitled "Water Utility Fund Historical Capacity Charge Revenues") of the Official Statement for the most recently completed fiscal year;

(vii) An update of the information contained in Table 12 (entitled "Water Customer Accounts Receivable and Shut-Offs by Fiscal Year") of the Official Statement for the most recently completed fiscal year;

(viii) An update of the information contained in Table 13 (entitled "Historical Sources of Water Service Revenues") of the Official Statement for the most recently completed fiscal year;

(ix) Information contained in Table 14 (entitled "Revenues, Expenses, Changes in Fund Net Assets") of the Official Statement for the most recently completed fiscal year;

(x) Information contained in Table 15 (entitled "Calculation of Historic Debt Service Coverage") of the Official Statement for the most recently completed fiscal year;

(xi) Information contained in Table 16 (entitled "Water Utility Fund Reserves") of the Official Statement for the most recently completed fiscal year;

(xii) An update of the information contained in Table 21 (entitled "City of San Diego Pooled Investment Fund") of the Official Statement as of the most recently completed fiscal year;

(xiii) Information contained in Table 22 (entitled "City of San Diego Schedule of Funding Progress") of the Official Statement for the most recently completed fiscal year;

(xiv) Information contained in Table 23 (entitled "City of San Diego and Water Department Pension Contribution") of the Official Statement for the most recently completed fiscal year;

(xv) Information contained in Table 24 (entitled "Water Department Retiree Health Contribution") of the Official Statement for the most recently completed fiscal year; and

(xvi) An update of the information contained in the Official Statement under the heading "Water System Financial Operations – Labor Relations – General" for the most recently completed fiscal year.

Any or all of the items listed above may be included by specific reference to other documents, including official statements of debt issues of the City or related public entities, which have been submitted to each of the Repositories or the Securities and Exchange Commission. If the document included by reference is a final official statement, it must be available from the Repositories. The City shall clearly identify each such other document so included by reference.

Section 5. Reporting of Significant Events.

(a) Pursuant to the provisions of this Section 5, the City shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Series 2009A Bonds, if material:

(i) Principal and interest payment delinquencies.

(ii) Non–payment related defaults.

(iii) Unscheduled draws on debt service reserves reflecting financial difficulties.

(iv) Unscheduled draws on credit enhancements reflecting financial difficulties.

(v) Substitution of credit or liquidity providers, or their failure to perform.

(vi) Adverse tax opinions or events affecting the tax–exempt status of the Series 2009A Bonds.

(vii) Modifications to rights of Bondholders.

(viii) Contingent or unscheduled Bond calls.

(ix) Defeasances.

(x) Release, substitution, or sale of property securing repayment of the Series 2009A Bonds.

(xi) Rating changes.

(b) Whenever the City obtains knowledge of the occurrence of a Listed Event, the City shall as soon as possible determine if such event would be material under applicable Federal securities law.

(c) If the City determines that knowledge of the occurrence of a Listed Event would be material under applicable Federal securities law, the City shall promptly file a notice of such occurrence with the Repositories. Notwithstanding the foregoing, notice of Listed Events described in subsections (a)(viii) and (ix) need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to holders of affected Bonds pursuant to the Indenture.

(d) If the Dissemination Agent has been instructed by the City to report the occurrence of a Listed Event, the Trustee shall file a notice of such occurrence with the Repositories with a copy to the City. Notwithstanding the foregoing notice of Listed Events described in subsections (a)(viii) and (ix) need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to the holders of affected Bonds pursuant to the Indenture.

Section 6. Termination of Reporting Obligation. The City's obligations under this Disclosure Certificate shall terminate upon the legal defeasance, prior redemption or payment in full of all of the Series 2009A Bonds. If such termination occurs prior to the final maturity of the Series 2009A Bonds, the City shall give notice of such termination in the same manner as for a Listed Event under Section 5(c).

Section 7. Dissemination Agent. The City may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this Disclosure Certificate, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. The initial Dissemination Agent shall be the City. The Dissemination Agent may resign as Dissemination Agent by providing thirty days written notice to the City and the Trustee. The Dissemination Agent shall not be responsible for the content of any report or notice prepared by the City. The Dissemination Agent shall have no duty to prepare any information report nor shall the Dissemination Agent be responsible for filing any report not provided to it by the City in a timely manner and in a form suitable for filing.

The City may satisfy its obligations hereunder to file any notice, document or information with a National Repository or State Repository by filing the same with any dissemination agent or conduit, including any "central post office" or similar entity, assuming or charged with responsibility for accepting notices, documents or information for transmission to such National Repository or State Repository, to the extent permitted by the SEC or SEC staff or required by the SEC. For this purpose, permission shall be deemed to have been granted by the SEC staff if and to the extent the dissemination agent or conduit has received an interpretive letter, which has not been revoked, from the SEC staff to the effect that using the agent or conduit to transmit information to the National Repository and State Repository will be treated for purposes of the Rule as if such information were transmitted directly to the National Repository and State Repository.

Section 8. Amendment; Waiver. Notwithstanding any other provision of this Disclosure Certificate, the City may amend this Disclosure Certificate, and any provision of this Disclosure Certificate may be waived (provided no amendment that modifies or increases its duties or obligations of the Dissemination Agent shall be effective without the consent of the Dissemination Agent), provided that the following conditions are satisfied:

(a) if the amendment or waiver relates to the provisions of Sections 3(a), 4 or 5(a), it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of an obligated person with respect to the Series 2009A Bonds, or type of business conducted;

(b) the undertakings herein, as proposed to be amended or waived, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the primary offering of the Series 2009A Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) the proposed amendment or waiver either (i) is approved by holders of the Series 2009A Bonds in the manner provided in the Indenture for amendments to the Indenture with the consent of holders, or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the holders or beneficial owners of the Series 2009A Bonds.

If the annual financial information or operating data to be provided in the Annual Report is amended pursuant to the provisions hereof, the first annual financial information filed pursuant hereto containing the amended operating data or financial information shall explain, in narrative form, the reasons for the amendment and the impact of the change in the type of operating data or financial information being provided.

If an amendment is made to the undertaking specifying the accounting principles to be followed in preparing financial statements, the annual financial information for the year in which the change is made shall present a comparison between the financial statements or information prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles. The comparison shall include a qualitative discussion of the differences in the accounting principles and the impact of the change in the accounting principles on the presentation of the financial information, in order to provide information to investors to enable them to evaluate the ability of the City to meet its obligations. To the extent reasonably feasible, the comparison shall be quantitative. A notice of the change in the accounting principles shall be sent to the Repositories in the same manner as for a Listed Event under Section 5(c).

Section 9. Additional Information. Nothing in this Disclosure Certificate shall be deemed to prevent the City from disseminating any other information, using the means of dissemination set forth in this Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Certificate. If the City chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Certificate, the City shall have no obligation under this Disclosure Certificate to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

Section 10. Default. In the event of a failure of the City to comply with any provision of this Disclosure Certificate, any Participating Underwriter or any holder or beneficial owner of the Series 2009A Bonds may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the City to comply with its obligations under this Disclosure Certificate. A default under this Disclosure Certificate shall not be deemed an Event of Default under the Indenture, and the sole remedy under this Disclosure Certificate in the event of any failure of the City to comply with this Disclosure Certificate shall be an action to compel performance.

Section 11. Duties, Immunities and Liabilities of Dissemination Agent. The Dissemination Agent shall have only such duties as are specifically set forth in this Disclosure Certificate, and the City agrees to indemnify and save the Dissemination Agent, its officers, directors, employees and agents, harmless against any loss, expense and liabilities which it may incur arising out of or in the exercise or performance of its powers and duties hereunder, including the costs and expenses (including attorneys fees) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's negligence or willful misconduct. The Dissemination Agent shall be paid compensation by the City for its services provided hereunder in accordance with its schedule of fees as amended from time to time and shall be reimbursed for all expenses, legal fees and advances made or incurred by the Dissemination Agent in the performance of its duties hereunder. The Dissemination Agent shall have no duty or obligation to review any information provided to it hereunder and shall not be deemed to be acting in any fiduciary capacity for the City, the Authority, the Series 2009A Bondholders, or any other party. Other than in the case of negligence, gross negligence or willful misconduct of the Dissemination Agent, the Dissemination Agent shall not have any liability to the Series 2009A Bondholders or any other party for any monetary damages or financial liability of any kind whatsoever related to or arising from any breach of any obligation of the Dissemination Agent. The obligations of the

City under this Section shall survive resignation or removal of the Dissemination Agent and payment of the Series 2009A Bonds.

Section 12. Beneficiaries. This Disclosure Certificate shall inure solely to the benefit of the City, the Dissemination Agent, the Participating Underwriter and holders and beneficial owners from time to time of the Series 2009A Bonds, and shall create no rights in any other person or entity.

THE CITY OF SAN DIEGO

By: ______________________________
Authorized Signatory

Attest:

____
City Clerk

APPROVED AS TO FORM:
MICHAEL J. AGUIRRE, City Attorney

By: ______________________________
Name:______________
Deputy City Attorney

EXHIBIT A

FORM OF NOTICE TO REPOSITORIES OF FAILURE TO FILE ANNUAL REPORT

Name of Issuer: The City of San Diego

Name of Issue: $[Par Amount] Public Facilities Financing Authority of the City of San Diego Water Revenue Bonds, Refunding Series 2009A (Payable Solely From Installment Payments Secured By Net System Revenues of the Water Utility Fund) (the "Bonds").

Date of Issuance: January __, 2009

NOTICE IS HEREBY GIVEN that the City of San Diego has not provided an Annual Report with respect to the above-named Bonds as required by Section 3 of the Continuing Disclosure Certificate dated as of January 1, 2009 executed and delivered by the City. [The City anticipates that the Annual Report will be filed by ____________________.]

Dated: ____________________

THE CITY OF SAN DIEGO

By: ______________________________

Title: ______________________________

APPENDIX H

INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM

THE INFORMATION IN THIS APPENDIX H CONCERNING THE DEPOSITORY TRUST COMPANY, NEW YORK, NEW YORK AND ITS BOOK-ENTRY SYSTEM HAS BEEN OBTAINED FROM SOURCES THAT THE CITY, THE AUTHORITY AND THE UNDERWRITERS BELIEVE TO BE RELIABLE, BUT THE CITY, THE AUTHORITY AND THE UNDERWRITERS TAKE NO RESPONSIBILITY FOR THE ACCURACY THEREOF.

The Depository Trust Company ("DTC"), New York, New York, will act as securities depository for the Public Facilities Financing Authority of the City of San Diego Water Revenue Bonds, Refunding Series 2009A (Payable Solely From Installment Payments Secured by Net System Revenues of the Water Utility Fund) (the "Series 2009A Bonds"). The Series 2009A Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered bond certificate will be issued for each maturity of each Series of the Series 2009A Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of the Series 2009A Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2009A Bonds on DTC's records. The ownership interest of each actual purchaser of each Series 2009A Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 2009A Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Series 2009A Bonds, except in the event that use of the book-entry system for the Series 2009A Bonds is discontinued.

To facilitate subsequent transfers, all Series 2009A Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of the Series 2009A Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2009A Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2009A Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. The City and the Authority will not have any responsibility or obligation to such Direct Participants and Indirect Participants or the persons for whom they act as nominees with respect to the Series 2009A Bonds. Beneficial Owners of the Series 2009A Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2009A Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Series 2009A Bond documents. For example, Beneficial Owners of the Series 2009A Bonds may wish to ascertain that the nominee holding the Series 2009A Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. The conveyance of notices and other communications by DTC to DTC Participants, by DTC Participants to Indirect Participants and by DTC Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Any failure of DTC to advise any DTC Participant, or of any DTC Participant or Indirect Participant to notify a Beneficial Owner, of any such notice and its content or effect will not affect the validity of the redemption of the Series 2009A Bonds called for redemption or of any other action premised on such notice. Redemption of portions of the Series 2009A Bonds by the Authority will reduce the outstanding principal amount of Series 2009A Bonds held by DTC. In such event, DTC will implement, through its book-entry system, a redemption by lot of interests in the Series 2009A Bonds held for the account of DTC Participants in accordance with its own rules or other agreements with DTC Participants and then DTC Participants and Indirect Participants will implement a redemption of the Series 2009A Bonds for the Beneficial Owners.

Redemption notices shall be sent to DTC. If less than all of the Series 2009A Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Series 2009A Bonds unless authorized by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Trustee as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Series 2009A Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payments of principal of, premium, if any, and interest on the Series 2009A Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Trustee, on payable dates in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC nor its nominee, or the Trustee, subject to any statutory, or regulatory requirements as may be in effect from time to time. Payments of principal of, premium, if any, and interest on the Series 2009A Bonds to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

NONE OF THE CITY, THE AUTHORITY OR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO DTC PARTICIPANTS, INDIRECT PARTICIPANTS OR BENEFICIAL OWNERS WITH RESPECT TO THE PAYMENTS OR THE PROVIDING OF NOTICE TO DTC PARTICIPANTS, INDIRECT PARTICIPANTS OR BENEFICIAL OWNERS OR THE SELECTION OF BONDS FOR PREPAYMENT.

DTC may discontinue providing its services as depository with respect to the Series 2009A Bonds at any time by giving reasonable notice to the City, the Authority or the Trustee. Under such circumstances, in the event that a successor depository is not obtained, bond certificates are required to be printed and delivered.

The City and the Authority may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, bond certificates will be printed and delivered to DTC.

In the event that the book-entry system is discontinued as described above, the requirements of the Indenture will apply. The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that District believes to be reliable, but District takes no responsibility for the accuracy thereof.

None of the City, the Authority, the Trustee or the Underwriters can and do not give any assurances that DTC, the Participants or others will distribute payments of principal of, premium, if any, and interest on the Series 2009A Bonds paid to DTC or its nominee as the registered owner, or will distribute any prepayment notices or other notices, to the Beneficial Owners, or that they will do so on a timely basis or will serve and act in the manner described in this Official Statement. None of the City, the Authority, the Trustee or the Underwriters are responsible or liable for the failure of DTC or any Participant to make any payment or give any notice to a Beneficial Owner with respect to the Series 2009A Bonds or an error or delay relating thereto.

Morgan Stanley and JP Morgan Securities
COMMUNITY REINVESTMENT ACTIVITY

This information is being provided in connection with the Fiscal Year 2009 Bonds - Water System (Refunding and New Money). Morgan Stanley & Co. ("Morgan Stanley") and J.P. Morgan Securities, Inc. (J.P. Morgan) are the proposed senior and co-senior manager, respectively, for the Water Revenue Bonds, Refunding Series 2009A. Attached is the information provided by the firms on their community reinvestment activity. A summary of the firm's community reinvestment activities within the California region including San Diego are provided.

Per the CRA Regulation: "The Community Reinvestment Act, enacted in 1977, is intended to encourage depository institutions to help meet the credit needs of the communities (or assessment areas) in which they operate, including low-and moderate-income neighborhoods, consistent with safe and sound banking operations.. An "Assessment Area" includes the geographies (or census tracts) where the institution has its main office, retail branches, and/or deposit-taking ATMs, as well as the surrounding geographies in which the institution originated or purchased a substantial portion of its loans."

Morgan Stanley. Prior to October 2008, Morgan Stanley was an investment bank and therefore not subject to the CRA or HMDA provisions. Morgan Stanley has restructured as a bank holding company, but currently has no commercial banking operations. Morgan Stanley voluntarily provided information on its community activities upon the City's request.

According to Morgan Stanley's submission, the firm has donated $3.7 million in 2007 and 2008 (year to date) respectively to local charities in California, including many in the San Diego region. Other programs include Annual Appeal Program where Morgan Stanley encourages employees to give to local charitable organizations, and also offers a partial match ($0.25 for each $1.00) for any employee donations. Other San Diego activity includes employees who are actively involved in the communities through community service and scholarship. Other information is detailed in Morgan Stanley's CRA attachments.

J.P. Morgan. J.P. Morgan Chase Bank, N.A does not have a main office, retail branch, or deposit-taking ATM in the City of San Diego. As a result, San Diego is not a JPMC CRA assessment area. Nationally, JPMC received an overall "Outstanding" CRA rating from the Comptroller of the Currency on January 1, 2007.

According to JP Morgan's submission, since 2005, the Bank has provided over 11,700 mortgage loans in the City of San Diego, of which 4.3% were made to low-or moderate-income borrowers and 15.5% were made for homes located in low-or moderate-income communities. Also, since 2005, the Bank has made over 30,400 small business loans in San Diego, of which, over 18.3% were made to business located in low-or moderate-income communities.

Morgan Stanley's CRA and HMDA information is included as attachments 1 and 2, respectively. J.P. Morgan's CRA and HMDA information is included as attachments 3 through 5.

Morgan Stanley and J.P. Morgan representatives will be available at the October 27/28, 2008, City Council meeting to address questions that the Council members may have on their firms' commitment to the region.

Attachments:
1. Morgan Stanley CRA Letter of October 3, 2008
2. Morgan Stanley HMDA Letter of September 30, 2008
3. Community Reinvestment Act Performance Evaluation
4. Overview of JPMorgan Chase Bank, N.A. Community Reinvestment Activities In the City of San Diego
5. JP Morgan Chase Bank, N.A. Letter of October 1, 2009

Attachment 1

Morgan Stanley

555 California Street
Suite 2200
San Francisco, CA 94104

October 3, 2008

Debt Management Department
City of San Diego
202 C Street, MS 7B
San Diego, CA 92101-3868

To Whom It May Concern:

Morgan Stanley & Co. Incorporated shares the City of San Diego's commitment to community involvement and investment. Although Morgan Stanley & Co. Incorporated is not a commercial bank and has no mandated community reinvestment obligations, we do voluntarily provide significant charitable donations to California programs and charities, including those in the San Diego area. Morgan Stanley Community Affairs provides over $10 million annually in the U.S. with three primary goals:

i) to create and deliver excellence in children's healthcare;

ii) to invest in students and faculty to create access and opportunity in the financial services sector for members of underserved communities; and

iii) to encourage, recognize and reward employee volunteer efforts.

Charitable Contributions in the San Diego Region. Morgan Stanley has donated $2.4 million and $1.3 million in 2007 and 2008 (year to date) respectively to local charities in California. This includes a wide variety of charities in the San Diego region including San Diego County Hispanic Chamber of Commerce, La Jolla Playhouse, Scripps Health Foundation, Torrey Pines High School, Copley Family YMCA, Rancho Sante Fe Art Guild, National Multiple Sclerosis Society, Juvenile Diabetes Research Foundation, United Cerebral Palsy Association of San Diego County, Empowering the Human Spirit Foundation, Invest in Others Charitable Foundation, Rady's Childrens Hospital, Elizabeth Hospice, and La Jolla Youth Baseball Association, among others.

Annual Appeal Program – Employee Donations. Morgan Stanley also sponsors an Annual Appeal Program which encourages employees to give to local charitable organizations, and also offers a partial match ($0.25 for each $1.00) for any employee donations. In 2007, there were 1,485 donations made by employees as part of the Annual Appeal program in California, including 91 donations to San Diego area charities covering a wide range of causes. Several of these charities are listed in the table below.

San Diego Area Recipients of Annual Appeal Program Funds in 2007

American Lung Association of San Diego	Conners Cause for Children	San Diego Humane Society & SPCA	United Way of San Diego County
American Melanoma Foundation	Freedom Is Not Free	San Diego State University	Univ of California - San Diego
American Red Cross - San Diego/Imperial Counties	Injured Marine Semper Fi Fund	San Diego Youth & Community Services, Inc.	University of San Diego
Autism Research Institute	Make-A-Wish Foundation - San Diego	Scripps Research Institute	Veterans Memorial Center Inc
Baja Animal Sanctuary	Mama's Kitchen	St. Vincent de Paul Village	Veterans Village of San Diego
Burn Institute	Rancho Coastal Humane Society	StandUp For Kids	Voices for Children San Diego
Childrens Hospital and Health Center	Salvation Army San Diego	Susan G. Komen Breast Cancer Foundation - San Diego Affiliate	YMCA of San Diego County
Children's School for Child-Centered Education	San Diego Hospice Foundation	SVDP Management Inc. - Father Joe's Villages	Zoological Society of San Diego

Community Involvement in the San Diego Region. In addition to donating money, Morgan Stanley and its employees are actively involved in their communities, including participating in Global Volunteer Month. In California, employees logged more than 2,500 hours of community service during this period for 185 organizations throughout the State. Organizations include many in the San Diego region including the San Diego Blood Bank, the San Diego County Animal Shelter, the San Diego County Parks Department, the San Diego River Park Foundation, the Encinitas Trails Coalition, the Encinitas Parks and Recreation Commission and the California Youth Soccer Association. Other southern California organizations that employees donated their time to included Cedars Sinai, the Boys and Girls Club of America, the Avon Walk for Breast Cancer, the American Cancer Society, Habitat for Humanity, the Laguna Beach Community Clinic, Special Olympics, Swim Pasadena, the Surfrider Foundation, the Thousand Oaks Civic Arts Plaza, various YMCA chapters and the Venice Family Clinic. We have included the latest issue of our "What a Difference a Day Makes" newsletter, which references the participation of some of our La Mesa employees in their local chapter of the National Multiple Sclerosis Society.

VolunteerMatch. The Firm also provides a tool for employees called VolunteerMatch which helps employees find local opportunities that fit their interests, as well as allow employees to recruit other employees to causes that they are passionate about. Currently the site lists 630 opportunities in San Diego County, including opportunities directly related to community development. This includes: Rebuilding Together Greater San Diego, El Cajon Community Development Corporation, City Heights Community Development Corporation, San Diego River Park Foundation, Nicodemus Wilderness Project. Through this tool, we hope to grow our community involvement, in San Diego, as well as across California.

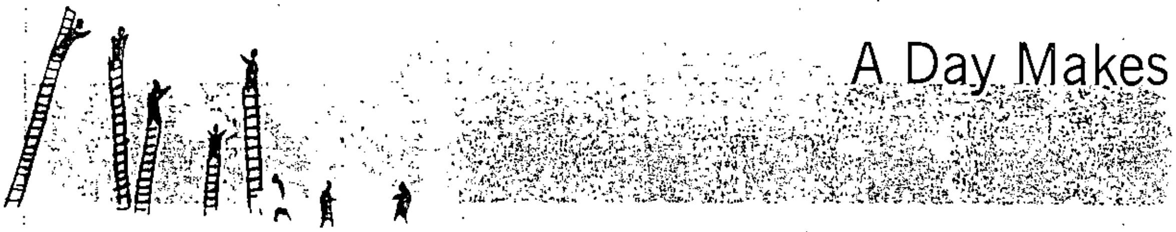
Scholarship Programs. Many other organizations that are significant recipients of funds from Morgan Stanley are focused on a particular issue nationwide rather than a specific region, and recipients of their funds can be from any region. This includes several scholarship programs for organizations including the American Indian College Fund, which provides scholarships for tribal college students studying business; the Hispanic Scholarship Fund (based in California), which gives scholarships to students from diverse ethnic backgrounds in the United States and Puerto Rico; the Robert A. Toigo Foundation (based in California), which gives scholarships, networking support, mentoring and practical work experience in the financial services industry for talented young men and women of color pursuing MBA degrees; and A Better Chance, which is a group of national education programs that create opportunities for academically talented students of color.

Please do not hesitate to contact us if we can provide further information about our programs and our commitment to community reinvestment.

Very truly yours,

/s/ John Sheldon	/s/ Margaret Backstrom

John Sheldon	Margaret Backstrom
Managing Director	Executive Director
Phone: (415) 576-2083	Phone: (415) 576-2073
Fax: (415) 591-4582	Fax: (415) 591-4586
john.sheldon@morganstanley.com	margaret.backstrom@morganstanley.com



Nationwide Employees Support Important Cause

In keeping with Morgan Stanley's dedication to healthcare, employees across the country participated in the National Multiple Sclerosis Society ("National MS Society") rides and walks, which take place throughout the year. In 2007, Morgan Stanley raised over $91,000.

Two members of the Chicago team, Meg Marks (Associate, Chicago, IL), left, and Connie Pappas (Manager, Chicago, IL), show off their MS riding shirts

This past June, 22 employees from Chicago braved the elements to help the fight against Multiple Sclerosis. **Ian Radomski** (Managing Director, Chicago, IL) is a board member for the Greater Illinois Chapter of the National MS Society and served as the team captain of the Chicago branch team called 'Team MS 4 MS.' This was his second year riding and he said he feels the ride is a great way to raise awareness and support the National MS Society. The first day was cold and rainy but the team fought through the bad weather. "I wanted to quit and cut my ride short given the elements," explained Radomski. "That said, it was quite evident to me that individuals with Multiple Sclerosis don't have the option to quit, they must fight MS every day. This was the inspiration to keep riding despite the terrible weather." The rest of the 22-member team also fought the unfavorable conditions to support the cause and not one person dropped out. **Betty Ann Alter** (Vice President, Chicago, IL) was a key member of the committee and rode for the first time this year. "The riders and volunteers

Continued on Page 2

Dallas Office Rallies Around Good Causes

The National New Accounts division in Dallas, TX, is busy this year giving back to the community. The group formed the Culture Committee, charging members with creating meaningful and applicable opportunities for the office to give back.

"Overall, we have discovered how rewarding it can be to give to others through our time, energy and monetary gifts. Although we set out to build relationships with those in our community, we have been surprised to see how much stronger the working relationships have grown between coworkers. These opportunities truly have been rewarding for everyone involved," said **Kelley Cherry** (Executive Assistant, Dallas, TX).

The effort began with a volunteer and fund-raising initiative in cooperation with the Dallas, Texas Scottish Rite Hospital for Children. Scottish Rite treats children with orthopedic conditions, as well as certain related neurological disorders and learning disorders. The hospital, solely funded by donations, is able to provide all services to its patients without cost. Through a contest, the Dallas office raised over $2,000. In addition, a group of 10 employees volunteered at the hospital in October. The volunteers played games and made crafts with the children who had been in the hospital over the weekend. The visit was such a success that Morgan Stanley employees visited again during the winter holidays. **Tonya Garrison** (Closure Specialist, Dallas, TX) was touched by the spirits of the children at Scottish Rite. She went on to say, "I didn't know what to expect going into the children's hospital for the first time, but after a few short hours, I felt incredibly blessed by the opportunity."

The Dallas office also spent a day at the North Texas Food Bank helping to organize and pack food for distribution. The Food Bank distributes perishable and nonperishable items to food pantries, soup kitchens and shelters in North Central Texas. In addition to

Dallas group with their donated toys. ROW 1: Kendra Landry (Servicing Support Representative), Mylene Moore (Processing Support Representative), Tammy Solis (Processing Support Representative), Margie Mathias (Servicing Support Representative), ROW 2: Liz Barboza (Quality Control Representative), Dana Perez (Servicing Support Manager), Cody Williams (Processing Support Representative), Shay Paul (Processing Support Representative), Lonnie Ammon (Processing Support Representative), ROW 3: Tonya Garrison (Closure Representative), Vanessa Macadory (Processing Support Representative), Wendy Maynard (Processing Support Representative), ROW 4: Kelley Cherry (Executive Assistant), Vanessa White (Processing Support Representative), Jon Benton (Operations Support Manager)

volunteering at the food bank, they have brought in canned goods and other nonperishable items on several occasions to donate to the Food Bank.

Additionally, 10 employees participated in the Susan G. Komen Race for the Cure. The entire office helped the participating group raise over $1,200 through a bake sale and a race between two employees to raise donations.

During the winter holiday season, the Dallas office hosted a toy drive for Toys for Tots, sponsored by the U.S. Marine Corps Reserve. **Tony Goodavish** (Vice President, Dallas, TX) spearheaded the campaign with the help of the Culture Committee. "The office was very excited about this campaign. It allows us as a team to give back to the community and make a difference in children's lives," said Goodavish.

Overall, the roundup of volunteer activities in the Dallas office was met with such a positive response that plans are being made to continue the acts of good work on an ongoing basis.

Continued from Page 1

Ohio team smiles for the camera before they head off to ride. TOP ROW, left to right: Mark Shupe (Former Branch Manager, Akron, OH), Steve O'Neill (Associate Vice President, Financial, Centerville, OH), John Ritter (Friend), Tony Ritter (Former Manager, Centerville, OH), April Ghory (CSA, Centerville, OH), Darrin Ashworth (Friend), MIDDLE ROW, left to right: David Petree (deceased, Financial Advisor), Barbara Jackson (Friend), Scott Rider (Friend), Gerri Meiners (Friend), Nance Kruh-Meyer (Friend), Steve Gibson (Friend), Dawn Whitacre (former MS CSA, Centerville, OH), Gary Hurst (Vice President, Financial Adviser, Centerville, OH), Jennifer Birkenshaw (Friend), BOTTOM ROW, left to right: Kata Meiners (Friend), Kimberly Theiss (Friend), Michelle O'Neill (Friend), Sean O'Neill (Friend), Marvin Flynn (Friend), Melanie Hurst (Friend), Cathy Doxsey (Friend)

From left to right, Joe Mercadante (Financial Advisor), Rick Gottlieb (First Vice President), Kim Golden (Associate Vice President), Herb Hartman (Vice President), Warren Wallschleger (First Vice President) get ready to participate in the 2007 MS Society Walk in Palm Beach Gardens

Steve Ferguson (Registered Senior Service Representative, West Valley City, UT) keeping up with his training while in Paris

were incredible and the support for our team from colleagues, family and friends was amazing," recalled Alter. The Morgan Stanley team raised over $30,000 and is looking to surpass that amount this summer. Chicago team members included: **Katie Boehm** (Vice President), **Robert Dressler** (Senior Vice President), **Brent Habitz** (Analyst), **Jeffrey Knupp** (Vice President), **William Matz** (Associate), **Meg Marks** (Associate), **Marty Mooney** (Analyst), **Tiara Nelson** (Analyst), **John Olvany** (Managing Director), **Connie Pappas** (Manager), **Alice Treska** (Administration) and **Andrew Winick** (Vice President), Chicago, IL.

Stephen F. O'Neill (Associate Vice President, Centerville, OH) heads the highest-grossing Morgan Stanley team in the nation. The team raised more pledge dollars than any other Firm team in any other National MS Society walk or ride nationwide in both 2006 and 2007. O'Neill's father was diagnosed with MS in 1980 and passed away at age 65, due to complications related to the disease. Starting in 2003, O'Neill became the route coordinator, creating and marking the routes each July prior to the event. In 2007, the National MS Society honored him as the Volunteer of the Year for the Ohio Valley Chapter. Firm participants included: **April Ghory** (Registered Client Service Associate), **Gary Hurst** (Vice President) and his daughter **April Whitehead** (Financial Advisor), Centerville, OH. **David Petree** (Financial Advisor, Centerville, OH), was honored posthumously, as one of the top fundraisers in 2007. While on a team training ride in June, he suffered a heart attack and passed away. Over $1,500 was raised in his name.

For the ninth year in a row, **Herbert Hartman** (Vice President, Palm Beach Gardens, FL) will field a team of Morgan Stanley employees to participate in the local MS Society walk. The team name is Cindy's Heroes, in honor of Hartman's wife, who has Multiple Sclerosis. Cindy is now reliant on a scooter and comes out each year to support the walkers. "You learn very quickly that everybody knows somebody who has MS. To everybody at Morgan Stanley who participates in a National Multiple Sclerosis Society event either by walking, biking or donating I thank them from the bottom of my heart," said Hartman. Members of the team included: **Rick Gottlieb** (First Vice President), **Joe Mercadante** (Financial Advisor), **Warren Wallschleger** (First Vice President), Palm Beach Gardens, FL and **Kim Golden** (Complex Administrative Manager, Palm Beach, FL).

Steve Ferguson (Registered Senior Service Representative, West Valley City, UT) represents Morgan Stanley in the Utah ride. "If you like to ride, it's a well-supported event, a good cause, and very difficult to do the 100 miles, so it's a personal achievement as well," said Ferguson.

In New York, **Marianne Bellino** (Executive Director, New York, NY) has headed the team for over five years. This year, **Michael Burgess** (Executive Director, New York, NY) and **Kate Matthews** (Vice President, New York, NY) organized the New York team. "The ride is an amazing way to do what I love, support those in need and even get to ride through the Lincoln Tunnel after they close it off to traffic, just for the event," said Matthews. For team member **Sean Murdoch** (Executive Director, New York, NY), the ride has special meaning. Doctors diagnosed him with MS two years ago. Murdoch is a former European professional hockey player and an active participant in a wide range of charitable organizations, but now has a new perspective on fundraising events.

"I always knew the money was going to a good cause, but now I know so many more details about the organization and disease and really understand the way each little donation can add up to making a huge difference," said Murdoch. Other members of the New York team included: **Jennifer Bradish** (Manager), **Terence Chin** (Manager), **Steve Choi** (Associate), **Joseph Cordisco** (Senior Manager), **John Cottrell** (Project Manager), **Daniel Holzer** (First Vice President), **Oliver Jahn** (Senior Audit Manager), **Ruslan Kharitonov** (Engineer), **Kasia Michalski** (Senior Manager), **Mark Nazzaro** (Application Developer), **Albert Wu** (Data Manager) and **Andrew Yu** (Manager), New York, NY.

In Colorado, **Todd Hauer** (Senior Vice President, Centennial, CO) is a board member, six-time captain and participant of his region's team. Hauer, who became involved due to a family connection with the disease, said the National MS Society's professionalism makes it a pleasure for him to do his part to raise funds. "I believe it is an illness which can be managed if not cured through research if funded at the proper levels." Members of the Colorado team included: **Shawn Fowler** (Senior Vice President), **Justin Frame** (Vice President) and **Chuck Neuens** (Vice President), Centennial, CO.

Following his diagnosis in January 1990, **Phil Bresnick** (Senior Vice President Investments, La Mesa, CA) and his wife became involved in raising funds to help stop the disease. Bresnick serves as a board member of the local National MS Society chapter. With his colleagues and friends, Bresnick participates in the San Diego walk and hosts tables at the chapter's annual National MS Society auction. Additionally, Phillip's son **Eric Bresnick** (Financial Advisor, La Mesa, CA) works with his father and rides for him each year.

Jack Entwistle *(Financial Advisor, Charlotte, NC)* began participating in the North Carolina National MS Society ride because of his enjoyment of biking. However, since 1992, when he started, the ride has come to hold much more meaning for him. "I started riding because friends were riding but as I learned more about Multiple Sclerosis and made friends who were diagnosed and met families who had diagnoses, I passed from just doing an event, to being serious and intentional about getting involved," said Entwistle. He rides tandem with his wife and now serves as a board member for the region.

Because of the large number of involved Firm chapters throughout the country, Morgan Stanley is a National Team. Sarah Klein, National MS Society Senior Manager of National Teams, commented on the great need for, and in turn, great impact of Morgan Stanley. "We put so much money into research to help find a cure; therefore we are extremely reliant on continuous and widespread donations. We rely so heavily on the support of our corporate members. The National Teams are our biggest and fastest growing source of income," said Klein. For more information on how to become involved, please contact Sarah Klein at 303-698-6100, x15126 or via e-mail at sarah.klein@nmss.org.

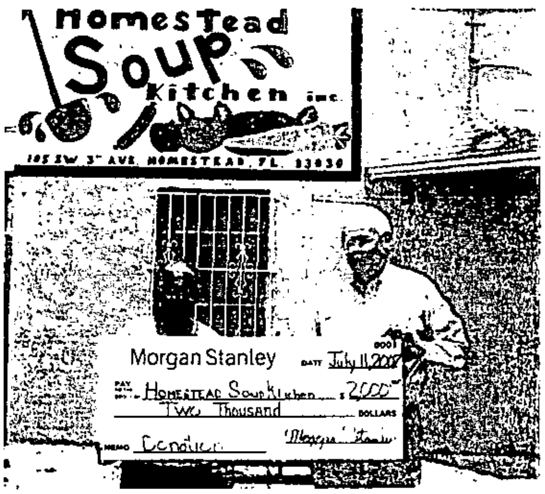
John Entwistle (Financial Advisor, Charlotte, NC) and his wife Wanda during the 2006 MS Society ride he Community Culinary School of Charlotte ("CCSC") provides food service job training for people who are chronically unemployed or unemployable. CCSC recruits students for the program from social service agencies, homeless shelters, halfway houses, the court system and work release programs. The school trains the students for employment in Charlotte's food service and hospitality industry while helping prepare 850 nutritious entrees daily for hungry and homebound recipients. Trainees participate in a 12-week program and receive education in professional food preparation, sanitation, work ethic and job search skills.

Jerry Dorenfeld (Vice President, Charlotte, NC) is one of the volunteers. "Conviviality is high among the regular volunteers and staff," said Dorenfeld, "I definitely appreciate the people I meet and especially those that are there full-time. Volunteering with CCSC is a good work-life balance. It adds another piece that is rewarding and you know that you are doing something good."

Local businesses also donate food to the school and employ many of its participants upon their graduation. CCSC places 98% of their participants in jobs post-graduation and serves over 300,000 meals to poor and hungry people in the region. For more information about CCSC, please e-mail Jerry Dorenfeld at Jerry.Dorenfeld@morganstanley.com.

Jerry Dorenfeld, second from left, and group serve the freshly cooked food at Community Culinary School of Charlotte

Helping to Save a Soup Kitchen



Jaunita Smith (Director, Homestead Soup Kitchen) left, accepts Morgan Stanley's donation presented to her by Dan Carter (Vice President, Key Largo, FL)

s a member of the local Kiwanis club, Dan Carter (Vice President, Key Largo, FL) has helped to serve food at the Homestead Soup Kitchen several times a year, for the last six years. The board of Homestead invited Carter to serve as a member last year. At his first board meeting, Carter learned that, due to a lack of funding, Homestead was in jeopardy of closing its doors, after having served the community for 24 years. Following a reduction in funding in 2006, the nonprofit had to fend for itself until it could reapply for additional aid. Carter stepped in to help raise funds to keep the soup kitchen cooking.

The Homestead Soup Kitchen serves over 200 meals, three days a week, to the homeless and hungry in the deep-south area of Miami-Dade County. Carter *raised more than 80% of this year's budget* by contacting the local media, sending letters of appeal to local places of worship and directly requesting funds from local businesses, including Morgan Stanley, and community leaders. The soup kitchen also relies entirely on volunteers during this time allowing all cash donations to go directly to the cost of food and nonemployee overhead.

"Often there is a misconception about who the hungry and homeless are. We have several families that come by and many with young children," explained Carter.

Carter plans to involve his fellow Morgan Stanley coworkers in Miami, to help with donations and with labor, to spruce up the facility. "I take a lot of pleasure and enjoyment in serving the community and getting things done," said Carter. For more information about the Homestead Soup Kitchen, please e-mail Dan Carter at Daniel.G.Carter@morganstanley.com.

Maryland's Miracle

nvestment News named Larry Adam Jr. (Senior Vice President, Baltimore, MD) one of three finalists nationwide for Volunteer of the Year for 2007. In 1987, Adam started Harvest for the Hungry because he recognized the need for food donations year round, rather than just during the holidays when giving is most popular.

"A long time ago I and five other people held a food drive around the holidays. The drive was very successful but after the holidays were over, I thought to myself, "What's next?" People need food throughout the year," recalled Adam. It was then that he started Harvest for the Hungry.

He then partnered with the Maryland Food Bank to help with distribution. "If you ever doubt one person can really make a difference, you can look at Larry and say, 'Yes, indeed, that can really happen,'" said Deborah Flateman, CEO of the Maryland Food Bank.

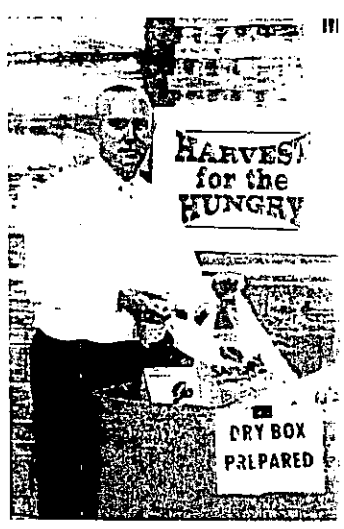
Investment News referred to Adam as "Maryland's Miracle," not only because of the food drives, but also because he brought the program into the local schools. Over 17 years ago, Adam had the idea to partner Harvest for the Hungry with the state educational program as a way of helping high school students fulfill their service requirement, which is a mandate for graduation.

Dr. Darla Strouse, Executive Director of Partnership and Recognition Programs for the Maryland State Department of Education said, "Often businesses and corporations will underwrite things and support initiatives, but rarely does a person from that organization spend the personal time making that relationship work. Partnering with Larry really has been a wonderful experience."

Adam runs the program out of his Baltimore office with assistance from Terrie Kilroy (Client Service Associate, Baltimore, MD) and support from Thomas New (Vice President, Baltimore, MD).

"As branch manger I have seen firsthand the impact Larry has on the community. Larry is not one to draw attention and it is amazing that he is able to run the whole program out of his office and still maintain a very impressive workload," said New.

For more information on Harvest for the Hungry, please contact Larry Adam at Larry.Adam@morganstanley.com or visit their website at www.mdfoodbank.org.



Larry Adam (Senior Vice President, Baltimore, MD) donates food at his signature event Harvest for the Hungry

Mitchell Kraft, with his father, Joseph Kraft (Senior Vice President, West Lake, OH), at an Autism Speaks event

s the parents of a child with autism, **Joseph Kraft** (Senior Vice President, Westlake, OH) and his wife were well versed in the world of available resources. The Kraft family was willing to do anything to bring their child back to them and found they already had been through almost all of the common services. However, while attending an autism-focused health fair, Kraft learned about a new organization, Autism Speaks, an advocacy group giving those with autism a voice. The organization raises funds for research of the causes and cures of autism.

Kraft said upon learning about Autism Speaks, "It finally hit me that my family has been so fortunate to have so much help from our community with our son Mitchell that it was time to give something back."

He jumped right in and became the Logistics Chair for Cleveland Walk Now for Autism, which in 2006 became the region's first annual Autism Speaks walk. Working closely with the City of Cleveland and a team of volunteers, Kraft secured everything: the route, public meeting space, entertainment and food. The event and Kraft's efforts received a high level of media attention from the local television stations and Cleveland Magazine, which covered his son's team.

The goal was to host 2,000 walkers and raise $200,000. They surpassed these numbers, having 6,000 walkers and raising over $600,000. "The people in the organization are most memorable to me, especially their generosity. It is amazing what we accomplished in such a short period. The volunteers gave it their all and it was amazing to see this event come together," recalled Kraft.

Kraft credited the success of the Cleveland walk to his opportunity to look at the model used by Autism Speaks chapters in other regions, specifically Pittsburgh. Beth Whitehouse, Executive Director of the Greater Pittsburgh chapter, recalled that it was a pleasure to work with Kraft: "Joe is one of the most outstanding volunteers I have ever worked with. He took all of the best practices for organizing a successful walk and put them into action. The walk was proof of his outstanding efforts, as representatives from Autism Speaks commented their disbelief that the Cleveland Walk Now for Autism was in its inaugural year. The event could have passed for being a veteran walk event because it was incredibly well run and organized. If cloning was legal, I would clone Joe to have him at each one of our walks across the country."

To find out more about the organization, please contact www.autismspeaks.org or Joseph Kraft at Joseph.Kraft@morganstanley.com.

Children enjoy the festivities at a Cause for Celebration party

ric Yamin (Executive Director, New York, New York) and his family started Cause for Celebration three years ago. The nonprofit organization focuses on building self-esteem in children born into substandard and compromised conditions by providing a day of celebration and recognition. The program bolsters the confidence of children whose living conditions pose a challenge to their emotional well-being.

As a parent of three young children, Yamin said he and his wife became increasingly aware of the challenges parents face every day to raise children who have good self-esteem, a positive self-image and confidence. The couple came to realize that tenderness, love and recognition are just as important as providing material necessities for a child to be emotionally healthy. "Helping a child develop high self-esteem is one of the best gifts a parent can give," said Yamin.

For thousands of children living in New York City who are born into abuse, neglect, abandonment, poverty, illness and homelessness, the environment for self-esteem to grow simply does not exist. Each Cause for Celebration event coincides with a milestone and/or accomplishment in a child's life, such as the holiday season or the end of an academic year. A memorable event celebrating 400 preschool children and their families took place in June 2007 at the Association to Benefit Children Echo Park Early Childhood Center. The event lasted five hours and included carnival entertainment, rides, live music, face painters, tattoo artists, costume characters, games, toys, a barbeque lunch, cotton candy, snow cones and cupcakes. At the end of the event, each child received a backpack tailored to fit his or her needs and interests. Items included brand new clothes for the summer, sneakers, school supplies and toiletries. "A child's appearance determines not only how others view that child but how that child views himself or herself. When a child in need can enter a classroom or summer program with his or her head held high, this goes a very long way to building self-esteem, dignity and confidence. This leads to increased participation and focus in classroom and recreational activities. When this occurs, we have successfully achieved our mission," explained Yamin.

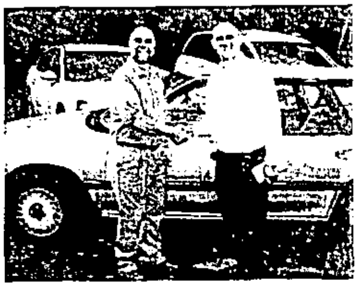
For more information on Cause for Celebration, contact Eric Yamin at Eric.Yamin@morganstanley.com.

ust after their second birthday, doctors diagnosed twins Morgan and Logan McBryar with leukemia. Since there are very few cases of twins diagnosed at the same time, their situation garnered a lot of attention from the medical world, the press and those wanting to help.

Todd Phillips (Branch Manager, Chattanooga, TN) was one of those people who stepped up to the plate to help the family. The twins, their brother and their mother lived in a trailer shared with their grandmother. The financial toll was significant, as both children needed expensive medical treatments and consistent care. Phillips collaborated with Candlelighters Childhood Cancer Foundation, a charitable organization that helps raise money to assist parents who are not able to work while caring for their sick children. During the course of the past year, the twins underwent regular therapy to treat the leukemia.

The Foundation, Phillips, and his fellow Morgan Stanley coworkers planned a fund-raising cookout to celebrate the twins' third birthday, at which over 60 people attended. "Their mother was very overwhelmed with everyone's gratitude and kept saying that the twins have never had a day like this before," said Phillips. Phillips said the twins' favorite present was the donation of a year-long pass to the Tennessee Aquarium and Children's Museum. The twins are doing better but need to continue regular treatments for another year. For more information on how to help the twins please e-mail Todd Phillips at Todd.Phillips@morganstanley.com or visit www.candlelighters.org.

The twins and a family member at their fund-raising birthday party



Neville Newton (Executive Director, Plaid House) accepts car donation from Keith Morrison (Vice President, Morristown, NJ), right

he Plaid House is a home for young displaced teenaged girls who do not live with their families. The intention of the Plaid House is to provide the residents a sense of structure, independence and growth so they are able to lead successful and happy lives. Located in Morristown, NJ, Plaid House is easily accessible from the local Morgan Stanley office. Because of its close proximity to her office and her church involvement, **Mary Grob** (Executive Director, New York, NY) first became involved with the House, serving as a mentor to a 16-year-old girl. After sharing her mentoring experiences with her Morgan Stanley colleagues, they volunteered as well.

Terry Tassopoulous (Vice President, New York, NY) organized a golf tournament, which raised enough funds to buy a much-needed new refrigerator for the House. **Keith Morrison** (Vice President, Princeton, NJ) donated his car. "When I donated the car to Plaid House, I let Neville Newton, the executive director of the facility, take a test drive and during the ride we had a long discussion about how much it meant for the charity to get a four-wheel drive car in excellent condition for free. It made me feel like what I had done was actually going to make a difference to the people on the receiving end," explained Morrison.

Bimonthly, Grob and friends from her church organize events for the girls. For more information, please e-mail Mary Grob at Mary.Grob@morganstanley.com or you can visit the website at www.Plaidhouse.com.

Morristown Employees Bring Pirate Carnival to Morgan Stanley Children's Hospital

he Morristown, NJ, office hosted a special day for the children at the Morgan Stanley Children's Hospital this fall. After **William Shinners** (Branch Manager, Morristown, NJ) took his staff on a tour of the hospital and the children's ward, the staff wanted to do something special for the children. Shinners formed a committee with **Judith Borger-Greenberg** (Branch Manager Assistant), **Donna Colucci** (Client Service Associate) and **Cindy Wagner** (Client Service Associate). The committee, in cooperation with the hospital administration, agreed on the idea of a "Pirate Party."

The party was a success, recalled Borger-Greenberg. "The patients all had a nice time. They came into the carnival as patients but they left as 'strong pirates.' We were even able to take the carnival on a cart and visit some of the children who were not ambulatory enough to come to the atrium area where the carnival was held." Employees who participated included: **Carolyn Bambaci** (Client Service Associate), **Geoffrey Close** (Wealth Advisor), **Shelia Crowley** (Client Service Associate), **Ralph Diaz** (Vice President), **Christina Flores** (Registered Client Service Associate), **Judy Greenberg** (Branch Manager's Assistant), **John Kovacs** (Wealth Advisor), **Dennis Morrison** (Vice President) and **Katrina Samaniego** (Registered Client Service Associate), Morristown, NJ.

Morristown Employees dressed and ready to spread some pirate cheer at the Morgan Stanley Children's Hospital. TOP ROW, left to right: Ralph Diaz (Vice President), William Shinners (Branch Manager), Cindy Wagner (Client Service Associate), Dennis Morrison (Vice President), Donna Colucci (Client Service Associate). MIDDLE ROW SEATED ON STEPS, left to right: John Kovacs (Wealth Advisor), Poonam Agarwala (Client Service Associate). MIDDLE ROW STANDING, left to right: Geoffrey Close (First Vice President), Dana Colucci (family member), Carolyn Bambaci (Client Service Associate), Shella Crowley (Client Service Associate), Jess Colucci (family member) and Sparky the dog. SEATED BOTTOM ROW, left to right: Katrina Samaniego (Client Service Associate), Christina Flores (Client Service Associate), Brett Wagner (family member), Judy Greenberg (Branch Manager's Assistant), Jason Brelinsky (Client Service Associate) and Christopher Colucci (Client Service Associate)

Lighting the Way to a Cure

The 2008 Morgan Stanley Light the Night Walk team. Firm employees, BACK ROW, left to right: Angelica Kalancha (FID), Gina Truglio (Manager), Sunil Fernandez (Associate), Steven Lieblich (Managing Director) and Eddie Ramos (Executive Director). MIDDLE ROW, left to right: Meredith Yurko (Associate), Hale Elifoglu (Associate), Alexis Nissenbaum (Graduate Intern), Sasha Greene (Program Assistant), Ashley Kokaly (Executive Assistant), Kate Maloney (Executive Assistant). FRONT ROW, left to right: Danielle Shoup (Analyst), Olga Serhiyevich (Associate), Leon Pilar (Associate), Serena Cheng (Associate)

n support of The Leukemia & Lymphoma Society ("LLS"), over 50 Morgan Stanley employees participated in the 2007 Light the Night walk as fundraisers, volunteers and walkers. The group was spearheaded by **Olga Serhiyevich** (Associate, New York, NY) and highly supported by **Steven Lieblich** (Managing Director, New York, NY), who is a longtime board member of LLS.

Serhiyevich first became involved with the organization because of her mother, who is chief medical officer of a regional hospital in the country of Belarus. Medical issues have always been a part of the dialogue in her family. "Blood cancers are one of the most difficult to find cures for and any developments in the area benefit other types of cancer treatment as well. Also, LLS is one of the most efficient charity models where a very high percentage of what is raised goes directly to medical research or patient services, which appeals to me a business professional," said Serhiyevich.

The Firm team participated in the New York Brooklyn Bridge walk, which starts at the South Street Seaport. Walkers hold illuminated balloons to guide their way as they walk the bridge. Serhiyevich said one of the most memorable aspects of the event was "the feeling I got when I saw the Manhattan skyline lit by thousands of illuminated balloons in memory of survivors." In total, the Firm raised $41,828 for the Light the Night walk.

For more information on how to get involved, please contact Olga Serhiyevich at Olga.Serhiyevich@morganstanley.com or Stacey Landis at LLS, 212-448-9206 ext. 230. You can also visit the website at www.lightthenight.org.


Sunil Fernandes (Associate, New York, New York) at the Catholic Charities Office of Bereavement Ministry holiday party

Sunil Fernandes (Associate, New York, New York) spends two Saturdays every month as a grief counselor with the Catholic Charities Office of Bereavement Ministry. The parish-based Bereavement Support Groups of the Diocese of Brooklyn and Queens offers support and a listening ear to those who have faced a loss. Fernandes decided to volunteer as a grief counselor after seeing the opportunity listed on the Firm's Community Affairs website. "I wanted to give back a little. This seemed like a good opportunity to meet more people and help those in need," explained Fernandes. For more information or to get involved, please contact Ingrid Seunarine, Director, Bereavement Services Diocese of Brooklyn and Queens at 718-722-6214 or visit their website at www.ccbq.*org/bereavement.htm.*

For the second time this year, GWMG Risk Management in Jersey City, NJ, visited the Community Food Bank of New Jersey to lend a helping hand during the holiday season. The Food Bank serves approximately 500,000 people in need every year and distributes over 21 million pounds of food and other groceries in 18 New Jersey counties. Using their project management skills, the group divided and bagged 1,600 pounds of tricolor pasta. "We all felt grateful for the opportunity to step away from the office and reach out to those less fortunate and blessed than ourselves, especially during the Thanksgiving holiday season," said **Darlene Jiadi** (Associate, Jersey City, NJ). Participants included: **Steven Santos** (Executive Director), **Stella Gulino D'Orio** (Vice President), **Alex Giordano** (Vice President),


Stella Gulino D'Orio (Vice President, Jersey City, NJ) bags the pasta to be dispersed

Anthony Glodava (Vice President), **Amber-Noelle Anthony** (Associate), **Jeff Lombardi** (Analyst), **Jaclyn Watts** (Executive Administrator), **Brenda Ramos** (Executive Administrator) and **Diane Gonzalez** (Executive Administrator), Jersey City, NJ.

Bryan Wollheim (Vice President, Mesa, AZ) is an active participant and fund-raising organizer with the Back-to-School Clothing Drive Association ("BTSCD"), which provides clothes to less fortunate children in the Phoenix metropolitan area. The annual clothing distribution is a one-week event held at a central Phoenix location, serving over 5,000 needy children. "The most memorable aspect of *working with the organization is seeing how you can* help kids with so little," said Wollheim. In addition to the clothing drive, Wollheim organized BTSCD's golf fundraiser and recruited his coworkers to join him in the effort. Participants in the fundraiser included: **Sergio Canevett** (Financial Advisor, Mesa, AZ), **William Kulesh** (Vice President), **Steve Ledyard** (Vice President), **Andrew Siegel** (First Vice President), **Chris Stocks** (Senior Vice President), Scottsdale, AZ and **Sarah Whitmore** (Vice President, Surprise, AZ).

After a hiatus of at least four years, the Chicago Complex sponsored a Blood Drive for the Morgan Stanley employees. The Chicago Complex consists of three branches and over 180 employees. **Bill McIntosh** (Registered Client Service Associate, Chicago, IL) is the Chairman of the complex advisory council. He gives blood regularly and organized the Blood Drive along with other members of the council. "The Center was impressed by the turnout for what they considered a "First Time Drive" at this location," said McIntosh. In all, 34 people participate in the drive. The complex hopes to make the drive a regular event, which will complement their other volunteer activities, including holiday gift-giving to needy children and beach cleanup at Lake Michigan.


Rich Romano (Vice President, Salt Lake City, UT) smiles during a visit to the *Bad Dog Rediscovers America* Headquarters

Bad Dog Rediscovers America is a youth-focused art-mentoring program located in downtown Salt Lake City. **Rich Romano** (Vice President, Salt Lake City, UT) serves as their Treasurer and oversees development activities.

The organization recruits experienced artists and mentors to help at-risk youth between the ages of five and 18 develop their creative skills and strive for excellence in drawing, painting, sculpture, architecture, creative writing and digital multimedia. "I have had the pleasure of getting to know three *kids in particular who have each been involved in the* organization for over a decade," said Romano. "It has changed the outcome of their lives."

In the future, Romano plans to involve the Utah area Morgan Stanley offices in Bad Dog Rediscovers by arranging regional offices to display the children's art. For more information, please visit www.baddogkids.org or contact Rich Romano at Rich.Romano@morganstanley.com.

DOROT is a charitable organization with the mission to enhance the lives of the elderly in the Greater New York City Metropolitan area by fostering interaction between the generations through their home meal-delivery programs and the Westchester Telephone Friends program. **Keren Lipnowski** (Associate, *New York, NY) is a volunteer with the meal delivery* program and provides a hot meal and conversation for an elderly person four times a year, during key holidays. "It means the world to them to have these visits and engage in activities and conversations with people that care about them," said Lipnowski.

Morgan Stanley employees have also made strong connections with the elderly through the Telephone Friends program. The program matches Firm employees with elderly to have a friendly and meaningful conversation over the phone once a week and is currently recruiting new volunteers. For more information on DOROT please e-mail Melanie Kane at mkane@dorotusa.org or visit their website at www.dorotusa.org.

Cancer is the number one cause of death in Alaska. Additionally, it is the only state in the nation where cancer has surpassed heart disease as the number one killer. Doctors diagnose almost 2,000 Alaskans with the disease each year. Providence Alaska Foundation is helping by advancing the development of innovative healthcare services provided by Providence Health System in Alaska. With special concern for the poor and vulnerable, the Foundation works to increase the availability of technologies, equipment and programs for all Alaskans.


Al Parrish (left), Chief Executive for Providence Health & Services Alaska, and Clark Rush (Senior Vice President, Anchorage, AK) outside the newly completed Cancer Center

Clark Rush (Senior Vice President, Anchorage, AK) is a Vice Chair on their Executive Board and Steering Committee. Most recently, he helped in raising $20,000,000 for the new Cancer Center, Palliative *Care Program, Providence House* and Hospice Care. "The most memorable thing about working with Providence is that the people have a passion, spirit and pride in working to make healthcare excellent for all Alaskans."

For more information contact Susan Ruddy, President of the Foundation, at 907-261-3600 or visit their website at www.providence.org/alaska/foundation/powered/bypassion.htm.

Mark Wan (Manager, New York, NY) and his wife planned and went on mission/service to Kenya, Africa last summer. The couple volunteered through "Mission Discovery," a program that organizes service-oriented trips for junior high, high school and adult church groups internationally. "The most memorable experience was volunteering alongside my wife and with the local people on Mfangano Island in Kenya," said Wan. The annual trips last from one to two weeks and range in location. The couple helped to build homes for the community. For more information about the opportunity, please contact Jerry O'Sullivan at Shelter Rock Church www.shelterrockchurch.com. In addition, you can find out more about Mission Discovery at www.missiondiscovery.com.


Mark Wan (Manager, New York, NY) jokes around with children from the local village

Prior to his career in the brokerage industry, **Bob Solis** (Senior Vice President, Surprise, AZ) worked in social services for children as a fundraiser. He always had a soft spot in his heart for kids. In May of 2005, he went to South Africa with his wife and five children to work in an orphanage in Johannesburg. Seeing the great need for services for orphans, the Solis family felt compelled to do something about the problem. As a result, in August of 2005, Solis purchased a 70-acre farm and in March of 2006, opened the doors of Open Arms Home for Children in Komega, East Cape, South Africa. Currently, it is home to 24 children with more anticipated to come in the months and years ahead.

The East Cape province of South Africa is the poorest province in South Africa. Almost 25% of the adult population is HIV-positive and the unemployment rate is approximately 50%. "All of the existing children's homes are full and so we are taking kids who literally have nowhere else to go. With my experience in fund-raising, we felt that we could raise the operational costs to keep things moving forward and make a very small difference in a very big problem. So far, so good!" said Solis.

Open Arms will soon reach the full capacity of 30 children in the main house and two cottages. Open Arms has plenty of room to expand, and in an effort to raise funds and awareness for the project, Solis is embarking on a four-month walk across the entirety of South Africa. "It's really a pretty crazy idea but I am hopeful that we will be able to raise $250,000 to build eight new cottages that will house up to 50 additional kids," explained Solis. In many African cultures, walking to meet someone is a sign of respect. Solis said he wanted to take this walk to show respect for the hundreds of thousands of orphans in sub-Saharan Africa and raise awareness of their plight.

Solis recalls the first child who came to Open Arms. His name is Sifundo, which in the local Xhosa language means "A Lesson." Solis said Sifundo officially transformed Open Arms from an idea to a reality: "It hit me like a ton of bricks. It was a day I'll always treasure," said Solis.

Sifundo was from just outside the property of Open Arms, which is in a slum area. In 2007, Solis lead a tour of several Americans to show them the area. He recalls passing the shack of a mother and her young 1-year-old girl who was asleep on a mattress on the dirt floor. His instincts were to scoop up the child and take her to Open Arms. However, for obvious reasons he could not do that. Nine months later, on a visit to the same area, he learned that the child and her mother both had died of AIDS. "Their memory often spurs me on," said Solis.

Solis said his colleagues, **Sarah Whitmore** (First Vice President, Surprise, AZ) and **Mag Black** (Regional Director, Los Angeles, CA), are very supportive of his efforts. To learn more about Open Arms, please contact Bob Solis at 623-875-2432, or at Robert.Solis@morganstanley.com.

Bob Solis (Senior Vice President, Surprise, AZ) with his family from left to right, Jaala, Lou Ann, Bob, Sallie, Alicia, Jonsy, Sammy

Firm Siblings Work Together and Volunteer Together

Brother and Sister team, Dan Holzer (First Vice President) and Denise Holzer (Financial Advisor) prepare to speak with employees about A.C.E.

Brother and sister team **Denise Holzer** (Financial Advisor) and **Daniel Holzer** (First Vice President) of the Holzer Group in the Firm's Third Avenue Branch in New York City, New York, not only work together, but also help the community together. The Holzer siblings work closely with The Association of Community Employment Programs for the Homeless ("A.C.E."). A.C.E.'s mission is to enable homeless men and women to reenter the workforce and to achieve long-term economic self-sufficiency. Through their initiatives, the SoHo & TriBeCa Partnerships, they offer an intensive four-month job training and a job placement program. Participants perform community maintenance such a street sweeping, emptying garbage cans, snow removal and tree care. Weekly job readiness workshops focus on resume writing, job search techniques, conflict resolution and living skills such as money management and budgeting techniques. The Holzers volunteer as fundraisers, mentors and resume tutors. "Making a difference in the community I both live and work in is a wonderful opportunity, one that I enjoy and am so glad I get to participate in," said Daniel. Daniel first became involved in A.C.E. through his sister, who has been an active volunteer since she joined Morgan Stanley in 2004.

Denise became involved in A.C.E. after meeting the founder, Henry Buhl, and hearing his story. "The same homeless man used to ask him for money every morning on his way to work. And, Henry would always give him something. Then one day, he gave the man an offer: Henry would continue to pay him every morning if he could sweep his street in SoHo. Inspired by the experience, Buhl decided to start a nonprofit that would help homeless individuals fight back by giving them the chance to learn the skills to hold a job," explained Denise. Eighty-seven percent of the A.C.E. graduates remain employed full-time.

Hearing success stories from former homeless men and women who now have jobs and are living independently, is the most memorable and meaningful aspect of being involved in the organization, recalled Denise, especially since it is not easy to get a job if one has never worked. "I remember hearing a story from a young kid from the Bronx who was selling drugs so that he could pay his way through college and one day he was arrested and ended up in prison at Rikers Island, NY for six months. He was 21 years old. Upon his release, he vowed never to go back to prison. Yet, he had never held a job before and did not even have basic skills. He credited A.C.E. for saving him, even though he had to sweep the streets of SoHo for a small stipend. It was his first real job and taught him the basics of showing up on time and how to interact with fellow workers. It was not easy because he had to be out on the streets sweeping rain or snow, on some of the coldest days of the year. But this made him stronger and the support system through A.C.E. helped him get through tough days," said Denise.

The Holzers spread their volunteerism to other organizations as well. Most recently, Daniel participated in the National Multiple Sclerosis Society bike ride.

For information on A.C.E., please contact Susan Needles at A.C.E. at 212-274-0550 x25, sneedles@ace4homeless.org or Denise Holzer at Denise.Holzer@morganstanley.com.

Kentucky Branch Connects with Local Middle Schools

For the past four years, the Louisville, KY, branch has participated in "Make the Connection," a one-day mentoring program with the Jefferson County Public School system and the Middle School Coalition. On this day, each seventh grader, at every middle school, meets with a volunteer who explains the importance of all the choices they will make this year and in the future.

Terrie Alexander (Senior Service Associate, Louisville, KY) spearheaded her branch's involvement in the program in connection with her daughter, who is a middle school teacher. "We really open the eyes of the kids we meet," said Alexander. "I had a little boy ask me how it is that I can work at a brokerage firm since I am a woman. These children just don't realize the possibilities of what is out there."

Gary Grigg (Associate Vice President, Louisville, KY) grew up in government housing. He was fortunate to attend private school programs, which exposed him to opportunities that opened his eyes to resources he previously did not know existed. "I wanted them to know that there are options out there, which I at first did not know were out there. And, that just because you are in a tough position today doesn't mean that is where you are going to end up," explained Grigg.

Other Louisville colleagues who participated included: **Ron Bass** (Vice President), **Gary Bird** (Financial Advisor), **Kathy Cissell** (Associate Vice President), **Lisa Clark** (Associate Financial Advisor), **Rick Madden** (First Vice President), **Don Ragains** (Complex Service Manager), **Mark Sandbach** (Vice President) and **Arlene Schneider** (Sr. Client Service Associate), Louisville, KY.

For more information, please contact Terrie Alexander at Terrie.Alexander@morganstanley.com or 502-562-5149, or Susan Shortt, Jefferson County Public School System, Middle School Coalition and Make the Connection program coordinator at susan.shortt@jefferson.kyschools.us or 502-485-3946.

ovember 2007 was Morgan Stanley's first Global Environmental Awareness Month and activities took place around the world. "Exciting and educational events were held, from learning about climate change using a cutting-edge interactive simulator, to demystifying your 'carbon footprint,' to tackling the future of renewable energy investments, as well as volunteer opportunities to demonstrate your green thumb," said **Jim Butcher**, Director of the Office of the Environment.

To put Morgan Stanley's words into action, a volunteer event was coordinated with the Riverside Park Fund whose mission is to preserve and improve New York's classic waterfront green space. On the cold grey morning of November 9, 2007, 15 Morgan Stanley employees huddled around Kim Green, Volunteer Program Assistant for the Riverside Park Fund for their day's instructions. Morgan Stanley volunteers put on their gloves and began working hard to help refurbish the St. Claire Rose Garden from erosion. Around them were bags of fertilizer piled up high, hundreds of daffodil bulbs in mesh bags, a large spread of potted shrubbery, three trees and a pile of shovels in varying sizes. Debbie Sheintoch, Director of Volunteers for Riverside Park Fund said, "The group worked incredibly hard to get all the plantings in the ground before the rain, planting hundreds of bulbs and shrubs at the St. Claire Rose Garden. This work really aids in beautifying the area, providing additional green space for the local community and flora and fauna for birds and insects." The Parks ongoing volunteer opportunities include raking leaves, spreading woodchips, weeding, planting, removing invasive plants, cribbing and a whole host of other horticultural undertakings.

Other events around the globe included a green thumb cleanup volunteer event in Hong Kong's Mai Po Nature Reserve and international open learning sessions ranging from how to reduce your carbon footprint, to business opportunities in the environment. During the course of the month, the Firm held over a dozen highly attended events.

For more information on Morgan Stanley's commitment to the environment, please visit the Office of the Environment website at http://groupweb.ms.com/cs/web/fm/environment. To learn more about the Riverside Park Fund, please visit http://www.riversideparkfund.org.

Flying the Not Always Friendly Skies: Firm Employee Enables Burmese Refugees to Reach Destination

eborah Hundley (Assistant Vice President, Syracuse, New York) helped 11 Burmese refugees travel from New York City to Syracuse, New York. The group was on her late night flight when it was canceled, leaving the refugees stranded at a New York airport. A United Nations supervisor had made sure the refugees were safely on board the flight but was unreachable when the plans changed. Hundley stepped in when she saw the refugees needed help.

The group did not speak English but had a list of emergency numbers pinned to their coats. Every UN number Hundley called reached voicemail. Hundley then contacted the refugees' relatives in Syracuse, assuring them that the group was safe and spending the night in New York City. She also helped the refugees reserve a seat on the next morning's flight, get through security with their nonstandard passports and arranged to have them stay at her hotel.

"The most interesting part of the experience was eating breakfast with the group. I gave all of them a full American breakfast including pancakes, eggs and toast. After they began to eat toast with a fork and knife, I taught them how Americans butter it and eat toast with their hands," recalled Hundley. Everyone then packed up, made it back to the airport and arrived safely in Syracuse where the refugees' relatives and the local news were waiting for Hundley and the group.

Global Volunteer Month is [illegible]

Record Your Volunteer Hours

Tell Us Your Story!

Submit stories, photos and ideas to:

Morgan Stanley Community Affairs
Attn: Editors
Alexis Nissenbaum and Lina Klebanov

Contributing writers:
Sasha Greene
and Suzane Rhee

1633 Broadway, 20th Floor
New York, NY 10019
Tel: 212-537-1555

The mission of Morgan Stanley Community Affairs is to build the potential of individuals and families, to encourage and increase the impact of our employees' volunteer efforts and to strengthen relationships with the communities in which our employees live and work.

whatadifference@morganstanley.com

Chief Administrative Officer Tom Nides in the 1585 cafeteria with wished-for bikes that are ready for donation

For the 12th year in a row, Morgan Stanley participated in the New York Cares Winter Wishes campaign. This was a record-breaking year, with the Firm answering more than 3,700 letters and giving over 10,000 toys to disadvantaged children and teens in the New York Metro area. Chief Administrative Officer and New York Cares Board Member **Tom Nides** volunteered along with team leaders from Corporate Services **Phyllis Kronhaus** (Floor Administrator, New York, NY), **Doris Daniels** (Administration, New York, NY), **Bert Leacock** (Administration, New York, NY) and **Delores Finlayson** (Manager, Firm Management, New York, NY). The campaign was lead by **Cynthia A. Cintron** (Vice President, Corporate Services, New York, NY), who credits the giving accomplishments to the generous culture of Morgan Stanley: "The success of the campaign once again proves that when employees come together, the Firm can make a real difference."

Morgan Stanley

Morgan Stanley
555 California Street
Suite 2130
San Francisco, CA 94104

September 30, 2008

Mr. Michael J. Frattali
Supervising Management Analyst
Debt Management Department
City of San Diego
202 C Street, 7th Floor
San Diego, CA 92101

Dear Mr. Frattali:

Morgan Stanley & Co. Incorporated has not and does not provide residential mortgage financing, so accordingly, the Home Mortgage Disclosure Act (HMDA) disclosure requirements are not applicable to Morgan Stanley & Co. Incorporated. Please let me know if you need any additional information.

Very truly yours,

Margaret J. Backstrom

Margaret J. Backstrom
Executive Director
margaret.backstrom@morganstanley.com
(415) 576-2073

Attachment 3

LARGE BANK

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

PUBLIC DISCLOSURE

January 1, 2007

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

JPMorgan Chase Bank, N.A.
Charter Number: 8

1111 Polaris Parkway
Columbus, OH 43240

Office of the Comptroller of the Currency

Large Bank Supervision
250 E Street SW, Mail Stop 6-1
Washington, DC 20219-0001

NOTE: This document is an evaluation of this institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the institution. This evaluation is not, and should not be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion, or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

Overall CRA Rating

Institution's CRA Rating: This institution is rated **"Outstanding"**

The following table indicates the performance level of **JPMorgan Chase Bank, National Association (JPMCB N.A.)** with respect to the Lending, Investment, and Service Tests:

Performance Levels	(Name of Depository Institution) Performance Tests		
	Lending Test*	Investment Test	Service Test
Outstanding	X		
High Satisfactory		X	X
Low Satisfactory			
Needs to Improve			
Substantial Noncompliance			

* The Lending Test is weighted more heavily than the Investment and Service Tests when arriving at an overall rating.

The major factors that support this rating include:

JPMCB N.A.'s lending performance is excellent. The volume of community development loans and the responsiveness of these loans to identified needs in the bank's assessment areas were driving factors in elevating the bank's good lending performance to an excellent level.

- While four rated areas were rated Outstanding on the basis of geographic and borrower distribution and lending activity, another eight rated areas were elevated to Outstanding by the strength of community development lending. The Lending Test performance in all other rated areas was High Satisfactory.

- In total, JPMCB N.A. made over $5.7 billion in community development loans within its various assessment areas and broader regional areas that include its assessment areas. This figure for the bank as a whole is informational only, as ratings and conclusions in this evaluation are based on the bank's performance in the individual assessment areas and rating areas. Most (53%) of the community development loans made by the bank provided needed affordable housing. Another 23% of community development loans provided social services that assisted low- and moderate-income individuals and 22% helped to revitalize or stabilize low- or moderate-income geographies.

- In addition, the bank made 14 community development loans totaling over $215 million to national funds, projects, and organizations. These loans could not be attributed to a specific assessment area; however, the recipient organizations develop projects and provide services within the bank's assessment areas and broader regional areas. These loans demonstrate a positive commitment to community development efforts throughout the nation. Please refer to Table 1, Lending Volume Regional Areas-Loans to National Organizations in Appendix D for facts and data regarding these loans.

- The distribution of loans to geographies of different income levels is good. Broken down by product, home purchase and small business lending are each considered good while home improvement and refinance lending demonstrated excellent performance.

- The distribution of loans to borrowers of different income levels is good. By product, home purchase lending is adequate while home improvement, refinance, and small business lending are all good.

- Lending activity is excellent. JPMCB N.A. typically generated a large volume of loans in its markets, often despite strong competition. In most of its rated areas, the bank is among the market leaders. The volume of loans originated is reflective of the bank's resources and capacity.

JPMCB N.A.'s overall investment performance is good. This is evident through the volume of qualified investments and grants made during the evaluation period, and the remaining value of investments originated in prior periods. With these investments, the bank demonstrated excellent responsiveness to the identified community development needs of its communities, particularly through investment vehicles that promote affordable housing for low- and moderate individuals and funds to community service organizations.

- In total, JPMCB N.A. made over $3.9 billion in community development investments and grants within its various assessment areas and broader regional areas that include its assessment areas. Of this total, approximately $1.5 billion was originated in the current evaluation period and $2.4 billion was originated in prior periods and remains outstanding. These figures for the bank as a whole are informational only, as ratings and conclusions in this evaluation are based on the bank's performance in the individual assessment areas and rating areas. For prior period investments, the current book value is the amount considered in our evaluation. A vast majority of the total investments (93%) provided affordable housing, an identified need in many communities. Investments in social services organizations that assist low- and moderate-income people represent 3% of the total, 4% provided economic development and 1% helped to revitalize or stabilize low- or moderate-income geographies. In addition, the bank made $94.9 million in grants to national organizations, $87.7 million of which went to one organization, Consumer Credit Counseling Service (CCCS). These grants could not be attributed to a specific assessment area; however, the recipient organizations provide services within the bank's assessment areas and broader regional areas. These grants demonstrate the bank's commitment to community development efforts throughout its assessment areas and broader regional areas.

- Two of the bank's three Primary Rating Areas were rated Outstanding, with the third area rated High Satisfactory.

- Of the 22 assessment areas receiving a full-scope review, eleven and six exhibited excellent and good performance, respectively. Four of the five remaining full-scope areas demonstrated adequate performance, with the remaining area having poor performance.

- JPMCB N.A. and bank affiliates responded to affordable housing needs primarily through investment in Low-Income Housing Tax Credit (LIHTC) investments or acting as an equity placement agent for other investors into the LIHTC market. The bank is a consistent investor in the LIHTC market, and was second only to Fannie Mae in dollars invested in 2006.

JPMCB N.A.'s overall performance under the Service Test is good.

- The branch network is accessible to geographies and individuals of different income levels in the bank's assessment areas.

- JPMCB N.A.'s record of opening and closing branch offices has not affected the accessibility of its delivery systems, particularly in low- and moderate-income geographies.

- While branch hours vary by assessment area and within assessment areas, overall they do not vary in a way that inconveniences portions of the assessment areas, particularly low- and moderate-income geographies.

- We noted an excellent level of community development services in all but one of the rating areas. In many of the assessment areas, the bank provides financial services training to first-time homebuyers as well as to homeowners trying to preserve their homes. Frequently, the bank's services involve ongoing relationships with organizations that work on affordable housing and other community development goals.

CHASE

Overview of JPMorgan Chase Bank, N.A. Community Reinvestment Activities In the City of San Diego

J.P. Morgan Securities, Inc engages in investment banking activities in the United States. CRA activities are provided by JPMorgan Chase Bank, N.A., within its assessment areas. The Bank is evaluated periodically by the Office of the Comptroller of the Currency (OCC), to ensure that the credit needs of the communities it serves are met.

"The Community Reinvestment Act is intended to encourage depository institutions to help meet the credit needs of the communities (or Assessment Areas) in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound banking operations. An "Assessment Area" includes the geographies (or census tracts) where the institution has its main office, retail branches, and/or deposit-taking ATMs, as well as the surrounding geographies in which the institution originated or purchased a substantial portion of its loans."

JPMorgan Chase Bank, N.A. (JPMC) has a proven history of commitment to the goals of the CRA, and to community service. This commitment is exemplified by the consistent rating of ***OUTSTANDING*** compliance with the Community Reinvestment Act (CRA). In mid-2008, the OCC completed its most recent evaluation of JPMC's CRA activities, and again, JPMC received an Outstanding rating on the examination - dated January 1, 2007.

The information provided below is based on the most recent three-year period from January 2005 through December 2007.

Due to JPMC not having a main office, a retail branch, or a deposit-taking ATM in the City of San Diego, the City is NOT included as one of the charter's delineated CRA assessment areas.

JPMC has distinguished itself as a national leader in community development lending. JPMC provides financing for affordable housing and economic development projects in low- and moderate-income communities served by JPMC with a focus on facilitating:

- Low- and moderate-income housing development and rehabilitation
- Construction lending, interim financing, permanent financing, letters of credit
- Commercial revitalization projects in low- and moderate-income communities
- Technical assistance to intermediaries
- Community development loans to not-for-profit organizations

JPMC has a long tradition of market leadership in the area of mortgage lending, making innovative mortgage products available to meet the needs of all homebuyers. Additionally, JPMC offers a variety of programs and products designed to increase home-ownership among low- or moderate-income homebuyers and in low- or moderate-income communities. During the period between January 2005 and December 2007, the Bank made over 11,700 mortgage loans in the City of San Diego, of which 4.3% were made to low- or moderate-income borrowers and 15.5% were made for homes located in low- or moderate-income communities.

The Bank is also a market leader in the area of small business lending, making available a full range of competitively priced products designed to meet the needs of small businesses and their owners. These products include business installment loans, revolving credit lines, commercial mortgages, letters of credit, SBA-guaranteed loans, and business credit cards. For most products, loan size ranges from $3,000 to $250,000, with larger amounts considered under programs like the commercial mortgage and SBA programs. Interest rates can be fixed or variable, depending on the product. During the period between January 2005 and December 2007, the Bank made more than 30,400 small business loans in San Diego, of which, over 18.3% were made to businesses located in low- or moderate-income communities.

During the period of January 2005 through December 2007, the Bank originated $30.2 million in qualified community development loans in the San Diego regional area. These loans provide economic development opportunities for Native American areas within close proximity to the City of San Diego. These loans contribute to the revitalization/stabilization of these areas by provision of jobs to low- and moderate income individuals, and in low- and moderate-income areas. A couple examples of those qualified community development loans follows:

In December 2005, Chase closed a $15.5 million loan to a federally recognized tribe within San Diego County, California, for casino construction. The tribe has a high unemployment rate and most of the programs on the reservation are federally funded. For many tribes such as this one, tribal governments and federal government programs are the only sources of jobs available to residents for miles around. The facility is expected to create a significant number of jobs for the adults and educational opportunities for its students. Chase led the negotiations, identified other banks interested in the project, arranged the transaction for the tribe, and will serve as lead lender and administrative agent.

Also in December of 2005, Chase closed an $8.9 million loan to another federally recognized tribe in the San Diego area. This loan will be used to fund construction of a new gaming facility on the tribe's reservation. A significant number of the tribe's members are considered low- or moderate-income. This tribe is also primarily dependent on federal assistance, and has no significant financial wherewithal or economic enterprises that generate revenues. The casino is helping the tribe to achieve self-sufficiency, establish a successful long-desired economic development project and create employment on their reservation. JPMorgan Securities took the lead on this project. The bank led the negotiations, identified other banks interested in the project, arranged the transaction for the tribe, and serves as lead lender and administrative agent. In September of 2006, this loan was increased with Chase providing a $5.27 million share in the increase.

Again, although the City of San Diego, California is not a CRA assessment area for the JPMorgan Chase Bank N.A. charter, it has provided over $217,000 in grants to nonprofit, civic, and philanthropic organizations in and around the City of San Diego.

Attachment 5

J.P.Morgan

To: City of San Diego

From: J.P. Morgan

Date: October 1, 2008

Subject: JPMorgan Chase Bank, N.A Chase Home Mortgage Disclosure Act ("HMDA") Performance

Pursuant to your request, below please find the requested addendum to the "Overview of JPMorgan Chase Bank, N.A. Community Reinvestment Activities in the City of San Diego" as provided to the City on September 3, 2008 with respect to HMDA performance.

Overall, Chase's HMDA lending performance, which is largely retail branch driven, has been relatively strong across its bank footprint. Up until the recent acquisition of Washington Mutual ("WaMu"), Chase did not have any retail branches located in the State of California. With the acquisition of the WaMu retail branch network, Chase has now expanded its on the ground presence into many new markets, including California, allowing us a better opportunity to build and improve our HMDA lending performance in markets where, until recently, we did not have the benefit of a retail branch network. We also expect that having an expanded retail branch presence will also enhance our share of lending to minorities in those markets.

We look forward to future opportunities to expand J.P. Morgan's banking partnership with the City of San Diego and its residents.

Regards,

Gary Hall
Vice President
J.P. Morgan Securities Inc.

BACKGROUND INFORMATION ONLY

2009A and 2009B ASSIGNMENT AGREEMENTS

By and Between

SAN DIEGO FACILITIES AND EQUIPMENT LEASING CORPORATION

and

PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO

Public Facilities Financing Authority of the City of San Diego
[Subordinated] Water Revenue Bonds, Refunding Series 2009A and
[Subordinated] Water Revenue Bonds, Series 2009B
(Payable Solely From [Subordinated] Installment Payments
Secured by Net System Revenues of the Water Utility Fund)

Log of Outstanding Items- 2009A Assignment Agreement

Document	*Page No.(s)*	*Outstanding Items*	*Responsible Party*	*Expected Availability*[*]	*Completed*
2009A Assignment Agreement	3	• Signatures of the Authorized Signatory and the Secretary (the Corporation); F&J Partner; Authorized Signatory and the Secretary/Treasurer (the Authority); and the Deputy General Counsel to the Authority	The Corporation, F&J, The Authority and the General Counsel to the Authority	Preclosing	

[*] Refers to pricing, preclosing, etc. of 2009A Bonds, except where otherwise noted.

ASSIGNMENT AGREEMENT

by and between

SAN DIEGO FACILITIES AND EQUIPMENT
LEASING CORPORATION

and

PUBLIC FACILITIES FINANCING AUTHORITY
OF THE CITY OF SAN DIEGO

Dated as of January 1, 2009

relating to
Public Facilities Financing Authority of the City of San Diego
[Subordinated] Water Revenue Bonds, Refunding Series 2009A
(Payable Solely From [Subordinated] Installment Payments
Secured by Net System Revenues of the Water Utility Fund)

ASSIGNMENT AGREEMENT

THIS ASSIGNMENT AGREEMENT (this "Assignment Agreement"), executed and entered into as of January 1, 2009, is by and between the SAN DIEGO FACILITIES AND EQUIPMENT LEASING CORPORATION, a nonprofit public benefit corporation organized and existing under and by virtue of the laws of the State of California (the "Corporation"), and the PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO, a joint exercise of powers entity existing under and virtue of the laws of the State of California (the "Authority"),

WITNESSETH:

WHEREAS, the City of San Diego (the "City") desires to acquire, construct, install and *improve its Water System as more fully described in Exhibit A to the Installment Purchase* Agreement (as defined below) and as modified in accordance with the provisions thereof (the "Project"); and

WHEREAS, in order to effect such acquisition, construction, installation and improvement, the Corporation will sell components of the Project to the City pursuant to an Amended and Restated Master Installment Purchase Agreement, dated as of January 1, 2009 (as amended and supplemented from time to time, the "Installment Purchase Agreement") between the City and the Corporation; and

WHEREAS, the Authority's [Subordinated] Water Revenue Bonds, Refunding Series 2009A (Payable Solely From [Subordinated] Installment Payments Secured by Net System Revenues of the Water Utility Fund) (the "2009A Bonds") will be secured by the 2009A [Subordinated] Installment Payments (as defined in the 2009A Supplement (defined below)) to be made by the City pursuant to the Installment Purchase Agreement, as supplemented by the 2009 Supplement, dated as of January 1, 2009 (the "2009A Supplement"), will be [Parity Obligations] [Subordinated Obligations] as defined in the Installment Purchase Agreement, and will be issued and secured under that certain Indenture, dated as of January 1, 2009 (the "2009 Indenture"), by and between the Authority and Wells Fargo Bank, National Association, as Trustee (the "Trustee"); and

WHEREAS, the Corporation desires to assign to the Authority without recourse all of its rights under the 2009A Supplement, including, without limitation, its rights to receive 2009A [Subordinated] Installment Payments payable by the City to the Corporation under and pursuant to the provisions of the 2009A Supplement; and

WHEREAS, in consideration of such assignment and the execution and delivery of the Indenture, the Trustee has agreed to authenticate and deliver the 2009A Bonds; and

WHEREAS, all acts, conditions and things required by law to exist, to have happened and to have been performed precedent to and in connection with the execution and entering into of this Assignment Agreement do exist, have happened and have been performed in regular and due time, form and manner as required by law, and the parties hereto are now duly authorized to execute and enter into this Assignment Agreement;

NOW, THEREFORE, in consideration of the premises and of the mutual agreements and covenants contained herein and for other valuable consideration, the parties hereto do hereby agree as follows:

Section 1. Definition of Capitalized Terms. Capitalized terms used herein and not otherwise defined shall have the meanings given such terms in the Indenture.

Section 2. Assignment. The Corporation, for good and valuable consideration, the receipt of which is hereby acknowledged, does hereby unconditionally grant, sell, assign and transfer to the Authority, irrevocably and absolutely, without recourse, for the benefit of the Owners of the 2009A Bonds, all of its right, title and interest in and to the 2009A Supplement, including, without limitation, its right to receive the 2009A [Subordinated] Installment Payments to be paid by the City under and pursuant to the 2009A Supplement. Upon executing this Assignment Agreement, the Corporation shall have no right, title or interest in and to the 2009A Supplement, including, without limitation, the 2009A [Subordinated] Installment Payments.

Section 3. Acceptance. The Authority hereby accepts the foregoing assignment for the benefit of the Owners of the 2009A Bonds, subject to the terms and provisions of the Indenture, and all 2009A [Subordinated] Installment Payments shall be applied and the rights so assigned shall be exercised by the Authority as provided in the 2009A Supplement and the Indenture.

Section 4. Conditions. Excepting only the grant, sale, assignment and transfer to the Authority of the Corporation's right, title and interest in and to the 2009A Supplement pursuant to Section 2 hereof, this Assignment Agreement shall impose no obligations upon the Authority beyond those expressly provided in the 2009A Supplement and the Indenture.

Section 5. Further Assurances. The Corporation shall make, execute and deliver any and all such further resolutions, instruments and assurances as may be reasonably necessary or proper to carry out the intention or to facilitate the performance of this Assignment Agreement, and for the better assuring and confirming to the Authority, for the benefit of the Owners of the 2009A Bonds, the right, title and interest intended to be granted, sold, assigned and transferred pursuant hereto.

Section 6. Governing Law. This Assignment Agreement shall be governed by and construed in accordance with the laws of the State of California.

Section 7. Execution in Counterparts. This Assignment Agreement may be simultaneously executed in several counterparts, each of which shall be deemed to be an original and all of which shall constitute but one and the same instrument.

IN WITNESS WHEREOF, this Assignment Agreement has been executed by the Corporation and the Authority as of the day and year first written above.

SAN DIEGO FACILITIES AND EQUIPMENT LEASING CORPORATION

By:____________________________

Authorized Signatory

Attest:

By:____________________________

Secretary

APPROVED AS TO FORM:

FULBRIGHT & JAWORSKI L.L.P.,
AS COUNSEL TO THE CORPORATION

By:____________________________

Partner

PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO

By:____________________________

Authorized Signatory

Attest:

By:____________________________

Secretary/Treasurer

APPROVED AS TO FORM:

GENERAL COUNSEL TO THE AUTHORITY

By:____________________________

Deputy General Counsel

Public Facilities Financing Authority of the City of San Diego
[Subordinated] Water Revenue Bonds, Refunding Series 2009A and
[Subordinated] Water Revenue Bonds, Series 2009B
(Payable Solely From [Subordinated] Installment Payments
Secured by Net System Revenues of the Water Utility Fund)

Log of Outstanding Items- 2009B Assignment Agreement

Document	*Page No.(s)*	*Outstanding Items*	*Responsible Party*	*Expected Availability**	*Completed*
2009B Assignment Agreement	Cover	• Date of Agreement	City and Underwriter	TBD, Prior to pricing 2009B Bonds	
	Cover and throughout document	• [Subordinated] versus [Parity] Obligations	City and Underwriter	TBD, Prior to pricing 2009B Bonds	
	1	• Date of Agreement, Date of MIPA, Date of 2009B Supplement to MIPA, Date of Indenture	City and Underwriter	TBD, Prior to pricing 2009B Bonds	
	3	• Signatures of FELC Authorized Signatory and FELC Secretary, F&J, Authority Authorized Signatory, Authority Secretary/Treasurer and the Deputy General Counsel to the Authority	FELC Authorized Signatory and FELC Secretary, F&J, Authority Authorized Signatory, Authority Secretary/Treasurer and the Deputy General Counsel to the Authority	TBD, Preclosing for the 2009B Bonds	

* Refers to pricing, preclosing, etc. of 2009A Bonds, except where otherwise noted.

ASSIGNMENT AGREEMENT

by and between

SAN DIEGO FACILITIES AND EQUIPMENT
LEASING CORPORATION

and

PUBLIC FACILITIES FINANCING AUTHORITY
OF THE CITY OF SAN DIEGO

Dated as of _________ 1, 2009

relating to
Public Facilities Financing Authority of the City of San Diego
[Subordinated] Water Revenue Bonds, Series 2009B
(Payable Solely From [Subordinated] Installment Payments
Secured by Net System Revenues of the Water Utility Fund)

ASSIGNMENT AGREEMENT

THIS ASSIGNMENT AGREEMENT (this "Assignment Agreement"), executed and entered into as of _______ 1, 2009, is by and between the SAN DIEGO FACILITIES AND EQUIPMENT LEASING CORPORATION, a nonprofit public benefit corporation organized and existing under and by virtue of the laws of the State of California (the "Corporation"), and the PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO, a joint exercise of powers entity existing under and virtue of the laws of the State of California (the "Authority"),

WITNESSETH:

WHEREAS, the City of San Diego (the "City") desires to acquire, construct, install and improve its Water System as more fully described in Exhibit A to the Installment Purchase Agreement (as defined below) and as modified in accordance with the provisions thereof (the "Project"); and

WHEREAS, in order to effect such acquisition, construction, installation and improvement, the Corporation will sell components of the Project to the City pursuant to an Amended and Restated Master Installment Purchase Agreement, dated as of _______ 1, 2009 (as amended and supplemented from time to time, the "Installment Purchase Agreement") between the City and the Corporation; and

WHEREAS, the Authority's [Subordinated] Water Revenue Bonds, Refunding Series 2009B (Payable Solely From [Subordinated] Installment Payments Secured by Net System Revenues of the Water Utility Fund) (the "2009B Bonds") will be secured by the 2009B [Subordinated] Installment Payments (as defined in the 2009B Supplement (defined below)) to be made by the City pursuant to the Installment Purchase Agreement, as supplemented by the 2009 Supplement, dated as of _______ 1, 2009 (the "2009B Supplement"), will be [Parity Obligations] [Subordinated Obligations] as defined in the Installment Purchase Agreement, and will be issued and secured under that certain Indenture, dated as of _______ 1, 2009 (the "2009 Indenture"), by and between the Authority and Wells Fargo Bank, National Association, as Trustee (the "Trustee"); and

WHEREAS, the Corporation desires to assign to the Authority without recourse all of its rights under the 2009B Supplement, including, without limitation, its rights to receive 2009B [Subordinated] Installment Payments payable by the City to the Corporation under and pursuant to the provisions of the 2009B Supplement; and

WHEREAS, in consideration of such assignment and the execution and delivery of the Indenture, the Trustee has agreed to authenticate and deliver the 2009B Bonds; and

WHEREAS, all acts, conditions and things required by law to exist, to have happened and to have been performed precedent to and in connection with the execution and entering into of this Assignment Agreement do exist, have happened and have been performed in regular and due time, form and manner as required by law, and the parties hereto are now duly authorized to execute and enter into this Assignment Agreement;

NOW, THEREFORE, in consideration of the premises and of the mutual agreements and covenants contained herein and for other valuable consideration, the parties hereto do hereby agree as follows:

Section 1. Definition of Capitalized Terms. Capitalized terms used herein and not otherwise defined shall have the meanings given such terms in the Indenture.

Section 2. Assignment. The Corporation, for good and valuable consideration, the receipt of which is hereby acknowledged, does hereby unconditionally grant, sell, assign and transfer to the Authority, irrevocably and absolutely, without recourse, for the benefit of the Owners of the 2009B Bonds, all of its right, title and interest in and to the 2009B Supplement, including, without limitation, its right to receive the 2009B [Subordinated] Installment Payments to be paid by the City under and pursuant to the 2009B Supplement. Upon executing this Assignment Agreement, the Corporation shall have no right, title or interest in and to the 2009B Supplement, including, without limitation, the 2009B [Subordinated] Installment Payments.

Section 3. Acceptance. The Authority hereby accepts the foregoing assignment for the benefit of the Owners of the 2009B Bonds, subject to the terms and provisions of the Indenture, and all 2009B [Subordinated] Installment Payments shall be applied and the rights so assigned shall be exercised by the Authority as provided in the 2009B Supplement and the Indenture.

Section 4. Conditions. Excepting only the grant, sale, assignment and transfer to the Authority of the Corporation's right, title and interest in and to the 2009B Supplement pursuant to Section 2 hereof, this Assignment Agreement shall impose no obligations upon the Authority beyond those expressly provided in the 2009B Supplement and the Indenture.

Section 5. Further Assurances. The Corporation shall make, execute and deliver any and all such further resolutions, instruments and assurances as may be reasonably necessary or proper to carry out the intention or to facilitate the performance of this Assignment Agreement, and for the better assuring and confirming to the Authority, for the benefit of the Owners of the 2009B Bonds, the right, title and interest intended to be granted, sold, assigned and transferred pursuant hereto.

Section 6. Governing Law. This Assignment Agreement shall be governed by and construed in accordance with the laws of the State of California.

Section 7. Execution in Counterparts. This Assignment Agreement may be simultaneously executed in several counterparts, each of which shall be deemed to be an original and all of which shall constitute but one and the same instrument.

IN WITNESS WHEREOF, this Assignment Agreement has been executed by the Corporation and the Authority as of the day and year first written above.

SAN DIEGO FACILITIES AND EQUIPMENT LEASING CORPORATION

By:______________________________
Authorized Signatory

Attest:

By:__________________________
Secretary

APPROVED AS TO FORM:

FULBRIGHT & JAWORSKI L.L.P.,
AS COUNSEL TO THE CORPORATION

By:__________________________
Partner

PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO

By:______________________________
Authorized Signatory

Attest:

By:__________________________
Secretary/Treasurer

APPROVED AS TO FORM:

GENERAL COUNSEL TO THE AUTHORITY

By:__________________________
Deputy General Counsel